



The Optimal Decentralisation of Government Activity: Normative Recommendations for the European Constitution¹

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Abstract. This article surveys the research on the efficient assignment of policy tasks to different levels of government and applies the results on the delimitation of competencies within the EU. A precise derivation of an optimal degree of decentralisation is not possible on purely theoretical grounds, it has to be determined case-by-case. Systematic evidence on direct relationships between economic performance and fiscal decentralisation is both scarce and ambiguous. Comparing the actual and prospective delimitation of EU-competencies with the normative recommendations, remarkable discrepancies arise in the fields of agriculture and defence. The establishment of a flexible assignment scheme is an undeniable necessity in order to guarantee reversibility and to cope efficiently with changing conditions. In this respect, the European Convention has delivered insufficient results in its final draft Treaty as of July 2003.

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1. Introduction

“Although the protagonists of constitutional change couch their arguments mainly in the political language, economic issues have an immense underlying importance in determining the choice among different constitutional structures.” (Burrows 1980: 45)

At present we can observe “constitutional change” – or, better, the development of a new Constitution – in Europe. The constitutional debate has been opened, at least politically, with the “Declaration on the Future of the Union” included in the Treaty of Nice, and carried on with the “Laeken Declaration on the Future of the European Union” (15 December 2001), which poses the questions “[...] whether the simplification and reorganisation [of the Treaties] might not lead in the long run to the adoption of a constitutional text in the Union?” and “What might the basic features of such a constitution be?” Via the Laeken Declaration the European Council convened a Convention, whose task it will be “to consider the key issues

arising for the Union's future development and try to identify the various possible responses." This European Convention held its inaugural meeting on 28 February 2002 and has been working on the basic foundations of the future Constitutional Treaty since then. On 28 October 2002 Valéry Giscard d'Estaing, the Chairman of the European Convention, presented the Preliminary Draft Constitutional Treaty.³ Specific articles and protocols, as proposed for explicit inclusion into the final draft followed,⁴ based mainly on the final reports of the European Convention working groups, which were instituted in order to examine different constitutional subject areas.⁵ On 10 July 2003 the Convention completed its work and on 18 July 2003 they submitted the final version of the "Draft Treaty establishing a Constitution for Europe",⁶ adopted by consensus by the Convention on 13 June and 10 July 2003, to the president of the European Council in Rome⁷.

As stated in the introductory quotation, this process not only deserves analysis from a political or legal point of view, but also from an economic perspective. This article highlights the economic implications of the constitutional process in the European Union (EU) and focuses its analysis mainly on the competence question: What is the optimal assignment of policy tasks to the different levels of government within the EU? How can the competencies between the Union and the Member States be delimited optimally based on economic efficiency? The assignment of policy tasks within the EU has to take into account "the dispersion of authority away from central government – upwards to the supranational level, downwards to sub-national jurisdictions and sideways to public/private networks" (Hooghe and Marks 2001: 3). The question of an *optimal* assignment is a multifaceted one and can only be answered satisfactory summarising the results of different research disciplines: economics, political science and law. Scholars of political economy, public choice theory, (fiscal) federalism, decentralisation, European integration, regional and global regimes or international relations provide meaningful conclusions for this question. The chosen literature refers to these different disciplines and leads us to a survey, which focuses on the one hand on the economic circumstances determining the allocation question and constructs on the other hand linkages to the neighbouring disciplines. From the economic point of view we concentrate our survey primarily on the insights of the theory of fiscal federalism. Allocative efficiency arguments come to the fore, while income redistribution or macroeconomic management are only analysed marginally.

This article is organised as follows: Section 2 reviews the theoretical economic literature developed with regard to the assignment-question since the pioneer publications of Tiebout (1956), Oates (1972), and Musgrave (1959) (so-called "TOM-Models"). Basic pros and cons of decentralisation are highlighted and the trade-off between centralisation and decentralisation decisions is depicted. Section 3 reviews the current empirical evidence and provides a basis for further research and policy-making. Section 3 applies the insights of Section 2 and 3 to the actual constitutional process, compares the normative recommendations by function with the actual and prospective delimitation of competence and draws out the necessary procedural and institutional preconditions required to guarantee an efficient and

flexible assignment of policy tasks. Finally, Section 5 concludes by summarising the main results.

2. Assignment of Policy Tasks to Different Levels of Government: Theoretical Survey

The theory of fiscal federalism, or the economic theory of federalism, delivers crucial insights regarding the assignment question. “The main analytical task of fiscal federalism has been to define the appropriate assignment of allocative responsibilities to decentralised government levels and matching revenue sources” (Bird et al. 2002: 416f). Summarising the basic theoretical insights of fiscal federalism, we are able to filter out five fundamental features, which are decisive for our assignment question. These features, in turn, can be used as a kind of “checklist” in the case of practical decentralisation or centralisation decisions. The surveyed literature discusses predominantly decentralisation objectives. But in the case of centralisation questions (e.g., dispersion of authority upwards from the Member States (MS) to the EU-level), the insights from the decentralisation debate can be mirrored.

2.1. Theoretical Features of Fiscal Federalism

Many authors take the insights of the theory of public goods – namely the three famous “Musgravian branches” (Musgrave 1959) of governmental economic functions (allocation, distribution and stabilisation) as a starting point in order to explain the functional responsibilities of different levels of government (e.g., Persson et al. 1996; Andersson et al. 1997; Hemming and Spahn 1997; Vukovich 2000). The allocation branch is concerned with the production of goods and services for which competitive private markets fail to operate efficiently. Extending the theory of Samuelson (1954) regarding public goods to a spatial dimension, sub-national provision of pure public goods would be inefficient and can therefore be excluded (see Alesina et al. 2001; Eichenberger and Hosp 2001; Smekal 2001), whereas the provision of public goods, which are non-rival only at the local level, can be differentiated spatially (see Henke and Perschau 1999). In this connection, the appropriate degree of differentiation has to be determined. A lot of factors have to be taken into account, however the discussion of classical economists focuses primarily on economies of scale (as a criterion in favour of a centralised provision) on the one hand, and heterogeneity of local preferences (as a criterion in favour of a decentralised provision) on the other hand. Figure 1 depicts this basic tension and illustrates the difficult identification of the appropriate level of differentiation for each kind of activity. These two basic effects, as well as three further main features, which determine from our point of view decisively the assignment question, are filtered out from the existing literature in what follows. In this regard, Table 1 operates as a “guiding map”.

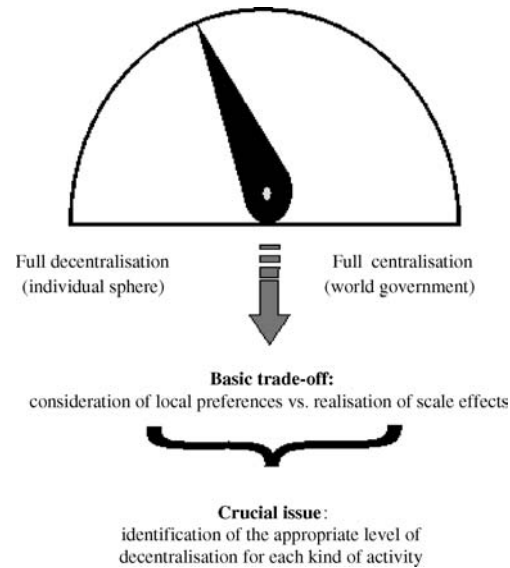


Figure 1. Derivation of an optimal degree of decentralisation.

2.1.1. *Optimal Consideration of Heterogeneous Regional Preferences*

Referring to the two central theorems of Oates (1972) – namely the *decentralisation theorem* and the *correspondence principle* – the significance of heterogeneous preferences becomes clear. Following the argument of Quigley (1997), assume that all households in a given area must consume the same amounts of the goods, necessitating some compromise. With any diversity of need among the population, a division into smaller groups of the population would likely result in less compromise among the citizenry. When population groups are smaller, the demands of any randomly chosen household will be closer to the demand of the average household in the group. Economic welfare will thus be improved, as the provision of services for each group is closer to each member household’s optimum. Therefore, a uniform level of public services offered in each community is inappropriate. “Pareto efficiency can be raised through fiscal decentralisation” (Thießen 2000: 5). Thus, governments should provide each public good including the respective set of individuals who consume the good: there is “perfect correspondence” in the provision of public goods (see Oates 1972: 34). Or as Cremer et al. (1994: 5) put it, “each type of good should be provided by a level of government [...] enjoying a comparative advantage in accounting for the diversity of preferences in its choice of service delivery.” To sum it up: a strong case in favour of decentralisation can be deduced from the consideration of the diversity of local preferences. However, meaningful critical remarks blur this clear recommendation.

Table 1. The assignment of policy tasks to different levels of government – theoretical survey.

Authors	Year	Analysed theoretical features of fiscal federalism	Major findings (not quoted in the text)	CEN	DEC
<i>I: Optimal consideration of heterogeneous regional preferences</i>					
Färber	2001	Optimal consideration of heterogeneous regional preferences, development of regionally diversified “production structures”. Advantages of “public administration federalism”	The administrative jurisdictions should have the possibility to differentiate their supply regarding the existing regional preferences: efficiency gains because of bundling and local information retrieval at a lower price		X
Smekal	2001	Optimal consideration of heterogeneous regional preferences			X
Zimmermann Henke	2001	Preference revealing problem	Because of the distance of the central level to local preference revelation, information, transaction, control or frustration costs could arise. Hint: fiscal illusions		X
Thießen Andersson Hårsman Quigley	2000 1997	Decentralisation Theorem Optimal consideration of heterogeneous regional preferences – linkage to the Theory of Public Goods			X X
Hemming Spahn Ter-Minassian	1997 1997	Preference revealing problem, Model of Tiebout Correspondence of expenditure priorities with local preferences		x	X X
Alesina Perotti Spolaore	1995	Efficient provision of bundles of public goods in different localities	Decentralisation of expenditure responsibilities should in principle lead to allocative efficiency gains. These gains may be negated by administrative weaknesses at the sub-national level Differentiated bundles and costless individual mobility allow efficient provision of public goods in a decentralised country		X

Table 1. (Continued)

Authors	Year	Analysed theoretical features of fiscal federalism	Major findings (not quoted in the text)	CEN	DEC
Tanzi	1995	Decentralisation theorem and correspondence principle			X
Cremer	1994	Comparative advantages in accounting of the diversity of preferences			X
Estache					
Seabright	1972	Optimal consideration of heterogeneous regional preferences: decentralisation theorem, correspondence principle			X
Oates					
Tiebout	1956	Optimal consideration of heterogeneous regional preferences: introducing mobility of citizens			X
<i>II: Realisation of economics of scale, internalisation of external effects</i>					
Behnisch	2001	Spill-over effects between jurisdictions and economic integration	Necessity of central co-ordination in order to internalise externalities. Consequently, efficiency gains and positive impacts on productivity growth can be realised by centralising several policy patterns	X	
Buettner					
Stegarescu					
Eichenberger	2001	Realisation of Economics of Scale		X	
Hosp		Internalisation of external effects			
Färber	2001	Minimization of transaction costs and internalisation of external effects	Necessity of certain central regulations in order to realise efficiency gains	X	
Hooghe	2001	Externalities and inter-jurisdictional co-operation	Distinction between two types of multi-level governance in the context of dispersion of authority:	X	X
Marks					

- Diminution of co-ordination costs by limiting the number of jurisdictions, setting up multi-task, general-purpose jurisdictions with non-overlapping territorial borders (Type I governance)
- Limitation of spill-over among jurisdictions by compartmentalising: a large number of (overlapping) jurisdictions is spawned while co-ordination is minimised among them (Type II governance)

Smekal	2001	Realisation of Economics of Scale	X
Schneider Wagner	2000	Internalisation of external effects	X
Vukovich	2000	Transaction, co-ordination and negotiation costs	X
Hemming Spahn	1997	Realisation of Economics of Scale	X
		Internalisation of external effects	
		Transaction, co-ordination and negotiation costs	X
Thomas	1997	Co-ordination can be tailored to specific functions and does not need a comprehensive regional approach. A supranational government will only play a catalytic role in such arrangements	X
Olson	1969	Development of a necessary condition for centralisation decisions	X
		A decentralised pareto-optimal solution seems to be implausible	X
<i>III: Inter-jurisdictional competition, division of labour</i>			
Von Hagen	2002	Functional Federalism: overlapping jurisdictions	X

Table 1. (Continued)

Authors	Year	Analysed theoretical features of fiscal federalism	Major findings (not quoted in the text)	CEN	DEC
Smekal	2001	Inter-jurisdictional competition and enforcement of innovations Functional Federalism:		x	X
Eichenberger Hosp	2001	overlapping jurisdictions Inter-jurisdictional competition and enforcement of innovations Functional Federalism:			X
Zimmermann Henke Frey Eichenberger	2001 1999	overlapping jurisdictions Tax competition and segregation tendencies Development of the Model of Functional, Overlapping and Competing Jurisdictions		X	
Henke Perschau	1999	Tax competition and sub-optimal allocation of resources		X	
Andersson Hårsman Quigley Thomas	1997	Comparative advantages Functional Federalism: overlapping jurisdictions Functional Federalism: overlapping jurisdictions			X
Cremer Estache Seabright	1994	Comparative advantages			X
<i>IV: Politico-economic variables</i>					
Eichenberger Hosp Thießen	2001 2000	Enforcement of democratic control and political information Leviathan-behaviour, central policy failure, bureaucratic quality			X
Andersson Hårsman Quigley	1997	Increasing institutional complexity hampers decision structures, flexibility in local administration		x	X

Thomas	1997	Leviathan-behaviour, central policy failure		X
Persson	1996	Second best effects of centralisation, effects on coalition formation		
Roland				
Tabellini				
Tanzi	1995	Corruption, bureaucratic quality	X	X
Oates	1995	Bureaucratic quality		X
Prud'homme	1994	Corruption, bureaucratic quality	X	
Brennan	1980	Leviathan-behaviour, central policy failure		X
Buchanan		As long as decentralisation spreads the power of government among numerous and small lower tiers, the danger of an excessive tax burden diminishes		
<i>V: Geography and demography</i>				
Färber	2001	Geographical distance between the jurisdictions	x	X
Thießen	2000	Size of the jurisdiction, degree of urbanisation, diversity of ethnic groups	X	
Alesina	1995	Size of the jurisdiction and economic integration; allocation of resources.		X
Perotti				
Spolaore		Geographically connected political jurisdictions		
Prud'homme	1995	Degree of urbanisation		X
Tanzi	1995	Size of the jurisdiction		
		More economic integration and freer trade should be accompanied by political separatism		
		A decentralised regime leads to a more efficient allocation of resources, by limiting the resources available to those agents who have an interest in distorting the economy		
		The higher the degree of urbanisation, the less difficult it is to decentralise		
		Break-up of the country instead of decentralisation		

Note: Normative recommendation: centralisation (CEN) or decentralisation (DEC), respectively. A “X” stands for unreserved responsibility of the respective level; a “x” stands for supporting/complementary involvement of the respective level. In the case of two “X”, both the central and the decentral level share the responsibility.

It seems very unrealistic to possess complete knowledge of the citizens' tastes – there appears the so-called “preference revelation problem” (see Hemming and Spahn 1997: 111). Although central governments could efficiently provide local goods, they are too remote from local interests: high information, transaction, control or frustration costs are the consequences (see Zimmermann and Henke 2001: 178ff). The decentralisation of several competencies would be the resultant suggestion. But information regarding preferences is also needed by localities – the preference revelation problem can only be solved introducing mobility of people into the Oates model. If public goods are financed by local taxes that reflect costs of provision, mobility between localities will provide the necessary information (see Tiebout 1956).

Factors accompanying the decentralisation process could offset to some extent the above delineated efficiency gains. One of them is “administrative weaknesses at the sub-national level, especially the lack of modern and transparent public expenditure management systems” (Ter-Minassian 1997: 22). More of these “hampering” effects are included in the remaining four determinants of our assignment question.

2.1.2. *Realisation of Economics of Scale, Internalisation of External Effects*

The realisation of economics of scale (EoS) and the internalisation of external effects are the main decisive factors for the assignment of functional responsibilities to the central government level. We can observe that average costs can be reduced with increasing output quantities. This is an argument in favour of a central provision of such goods. However, dealing with public goods, decreasing as well as increasing (e.g., costs in congested urban areas) average cost functions can be detected when additional output is produced (see Smekal 2001: 70). Furthermore, even in the case of decreasing costs the clear centralisation recommendation is blurred: information costs for local citizens, the lack of accommodation and near usage as well as control costs for the central level have to be taken into the assignment calculus. More pertinent arguments in favour of centralisation can be found by examining interregional spillover effects. Consequently, central governments deal with inter-jurisdictional externalities (e.g., pollution abatement) and regulate natural monopolies based on national networks (e.g., telecommunications) while local governments tend to control activities that have a regional limited impact (e.g., aircraft noise, in-city transportation) (see Hemming and Spahn 1997: 113). Coping with these externalities, different directions can be distinguished in the literature. On the one hand, the existence of interregional spillovers does not necessarily require the dispersion of the respective competence upwards to the central level (as claimed, e.g., by Smekal 2001), moreover grants-in-aid, fiscal transfers or horizontal co-operation among sovereign jurisdictions are valuable tools in order to internalise the externalities (see Pigou 1932; Hemming and Spahn 1997; Quigley 1997; Zimmermann and Henke 2001). On the other hand, externalities arising from the provision of public goods vary immensely – from planet-wide in the case of global warming to local in the case of most city services. In order to internalise these multifaceted externalities, *multi-*

level governance is demanded (see Hooghe and Marks 2001). In this regard, two different types of multi-level governance are observed (see Table 1).

As far as co-operation among jurisdictions is required in order to internalise externalities, we can distinguish opposite views again. On one side we have the opinion that co-operation can be tailored to specific functions and does not need a comprehensive regional approach (Hemming and Spahn, 1997: 113). A supranational government will only play a catalytic role in such arrangements. On the other side we may perceive negotiation and transaction costs in the case of inter-jurisdictional co-ordination (see Olson 1969; Thomas 1997; Schneider and Wagner 2000; Behnisch et al. 2001; Färber 2001), which could lead to welfare losses because of an unsatisfactory internalisation of the externalities. Inman and Rubinfeld (1992: 656) point out that public goods with significant cross-border externalities could also be provided by voluntary arrangements between member states. But – besides the fact that at a minimum, a central government administrative structure will be needed to enforce the arrangements – *efficient* provision should not be expected. This so-called “*decentral policy failure*” leads to a necessary condition regarding our centralisation decision: If the uncooperative behaviour of regions leads to worse results than the co-operative behaviour, and this co-operation is not credible without centralisation (because of free-rider effects), then the assignment to the central level would be necessary (see Thomas 1997: 168). This condition emblematises the famous *principle of subsidiarity*, which is inscribed in general terms in the Maastricht Treaty.

“Budgetary intervention at the Community level ought to be admitted only in the presence of cross-border externalities or economies of scale, which cannot be properly alleviated by a simple coordination between concerned national governments.” (Bureau and Champsaur 1992: 89)

2.1.3. *Inter-jurisdictional Competition, Division of Labour*

This third feature of fiscal federalism bears in mind the “benchmark-effect” of a multi-level structured government system. Decentralised systems strengthen political and organisational (bottom-up) innovations and enforce competition between the different authorities (see Eichenberger and Hosp 2001: 90; Smekal 2001: 70; Sinn 2003). They can realise efficiency gains by utilising their comparative advantages (see Cremer et al. 1994: 5) and by dividing labour efforts corresponding to the respective local resources.

While the previous arguments point to a decentralised system, there are arguments in the literature which deal with negative effects of inter-jurisdictional competition. In the field of taxation, for example, distorting effects of *tax competition* are focused and confronted with the alternative of a (EU-wide) tax harmonisation (see Sinn 1993; Austrian Institute for Economic Research [WIFO] 1998; Goodspeed 1999; Henke and Perschau 1999; Baldwin and Krugman 2000; European Parliament 2001; Fuest and Huber 2001; Pitta e Cunha 2002). Tax competition combined with a

high degree of inter-jurisdictional integration and mobility leads to inefficiently low taxation of capital, with sub-optimal allocation of resources as the consequence. Furthermore, redistribution from immobile to mobile factors takes place and could possibly lead to an undersupply of public goods (see Henke and Perschau 1999). Segregation tendencies are another critical phenomena often quoted in the case of tax competition: persons with higher income flock to jurisdictions with low tax rates for high incomes and supersede persons with low incomes, what in turn could aggravate social disparities (see Zimmermann and Henke, 2001: 183).

Combining the internalisation of externalities (see feature 2) and the division of labour, the concept of “Functional Federalism” plays a crucial role. In 1999, Frey and Eichenberger designed the Model of *Functional, Overlapping and Competing Jurisdictions* (FOCJ): the number of jurisdictions is vast rather than limited; they are not aligned on just a few levels, but operate at diverse territorial scales; they are functionally specific rather than multi-task and flexible rather than fixed; they guarantee vast representative and direct-democratic rights to their citizens and levy own taxes (see Frey and Eichenberger 1999; Hooghe and Marks 2001).⁸ On the one hand, FOCJs allow reactions on the technological developments that change the spatial characteristics of public goods over time (see Tanzi 1995: 299), guarantee democratic control and fiscal equivalence⁹ (see Eichenberger and Hosp 2001: 100), cope with the correspondence principle of Oates (1972) and “are an institutional way to vary the size of the jurisdictions in order to minimize spillovers” (Frey and Eichenberger 1999: 41). On the other hand, their establishment has to take organisational difficulties, economic costs (control, co-ordination, information, non-realised EoS) as well as a potential lack of transparency into account (see Thomas 1997: 163f; Smekal 2001: 71). Regarding these inconsistencies, the challenge of an optimal distribution of competencies cannot be simply satisfied establishing overlapping and task-specific jurisdictions; in fact, the optimal degree of decentralisation or centralisation, respectively, has to be detected for each policy task case-by-case. Nevertheless, in view of existing FOCJs and their increasing occurrence in many economies, we would not like to undermine the importance of the respective analysis. As Casella and Frey (1992: 645) emphasised: “even if an entire political system could not be organised solely through uni-dimensional clubs, still the role of these clubs should not be undervalued”.

2.1.4. *Politico-economic Variables*

Persson et al. (1996) reinforce our attempt to include also the neighbouring disciplines in the assignment-question by stressing the deficiencies of the classical “Pigovian” approach (TOM-Models), where generalised second-best arguments related to incentive constraints on the policy formation process are typically ignored. They adopt a broader politico-economic approach that addresses the second best effects of centralisation, as well as its effects on coalition formation.

“When allowing for political economy considerations, straightforward normative conclusions on the appropriate degree of centralisation are much more difficult to draw. The use of generalised second best arguments requires a case-by-case approach and careful empirical analysis.” (Persson et al. 1996: 3)

This conclusion explains the relative neglect of these variables in economic analysis, but also provides the linkage to Section 3 of this article, where the empirical insights regarding politico-economic variables are reviewed.

Evaluating the pros and cons of decentralised government structures, political economists usually link their analysis to the behaviour of revenue-maximising governments, to the effects of political competition or to the qualitative improvements of democracy. Starting with the “*fragmentation hypothesis*” or “*Leviathan restraint hypothesis*” of Brennan and Buchanan (1980), political economists try to check the relationship between a fragmented political system and the size of the public sector (see Kirchgässner and Schaltegger 2002, see also Table 3): The connection between government expenditures and revenues is strengthened by the existence of a fragmented system (hint: inter-jurisdictional competition pressure due to migration tendencies), stricter budget discipline is effectuated and therefore a diminution of the size of the public sector can be expected. Thus, an oversupply of public goods and x-inefficiency in the public sector can be prevented (see Thießen 2000: 8). These conclusions of political economists are based primarily on the “*central policy failure*” theorem: imperfect information, rent-seeking politicians as well as lobbying-activities of interest groups characterise the so-called Leviathan behaviour, which leads to a sub-optimal consideration of local preferences and hence to welfare losses. This influence of vested interests can only be weakened by the enforcement of the political responsibility of the government, what, in turn, can be reached satisfactory through decentralisation (see Thomas 1997: 168ff).

The augmentation of democracy through a federal system is a further argument in favour of decentralisation. On the one hand, the better consideration of local preferences and inter-jurisdictional competition lead to democracy improvements; on the other hand, federalism increases political information for citizens and transparency in public transactions, which reinforces moreover the proper functioning of democracy (see Eichenberger and Hosp 2001: 90). Fiscal decentralisation (FD) enhances political autonomy, which in turn motivates participation at the local level (see Ebel and Yilmaz 2002). However, arguments can also be found in the politico-economic literature which do not support the positive view of decentralised government systems. They rely on *corruption* at the local level and on the quality of governments. Following Prud’homme (1994), local elites are closer to people and hence more susceptible to personalism. They get improved access to public resources via decentralisation, what increases opportunities for corruption (see Tanzi 1995: 301). Wildasin (1995) is more careful regarding this proposition: “There may be a trade-off between local corruption on a small scale and central corruption on a large scale. It seems impossible to say a priori which would dominate the other.” (Wildasin

1995: 327). In fact, recent empirical attempts at settling this question have so far given inconsistent results: Treisman (2000) does not find any significant relationship between fiscal decentralisation and corruption (see Dabla-Norris and Wade 2002: 4), while in the cross-country regressions of Fisman and Gatti (2000) fiscal decentralisation appears to have a negative and significant effect on corruption (see Table 3).

Concerning the quality of governments, we have to bear in mind the trade-off between local knowledge at the sub-national levels and the overall competence of the central level (see Andersson et al. 1997: 98f). While the central level exhibits quality deficiencies because of scarce local knowledge, it may attract more qualified people because of better career opportunities and salaries and could therefore achieve a higher quality level (see Prud'homme 1994; Thießen 2000: 11). On the one hand, a scarcity of local talents could be the consequence and impede decentralisation efforts. On the other hand, “decentralised political institutions play an important role in developing skilled public administrators by allowing more widespread and direct participation in the affairs of government.” (Oates 1995: 351). Thus, it is difficult to give a clear recommendation to our assignment-question because of bureaucratic quality reasons. Again, a case-by-case approach is necessary.

2.1.5. Geographical and Demographic Variables

We have just stressed the quality of governments and the stock of human capital as meaningful determinants regarding the optimal assignment of policy tasks – now we proceed with further inherent characteristics of the different jurisdictions, namely with geographical variables. The size of the jurisdiction (and/or its population) is a decisive factor in order to evaluate the heterogeneity of preferences as well as the potential realisation of economies of scale. We could assume a strong relationship between the heterogeneity of preferences and the geographical distance between different jurisdictions (see Alesina et al. 1995: 754; Färber 2001: 112). The smaller the jurisdiction, the more homogenous are individual views, reducing the pronouncement of individual preferences: a decentralised structure cannot easily develop its benefits (see Thießen 2000: 12). Moreover, “small countries should be more successful than large countries in satisfying the social needs of their population. [...] there would be strong reasons for breaking up countries and weaker reasons for fiscal decentralisation.” (Tanzi 2000: 2). Thus, bearing in mind the discussion on FOCJs, essential tensions exist between the geographical demarcation of a jurisdiction and the decentralisation within a given limited geographical area.

The degree of urbanisation is another important geographical factor, which determines decentralisation decisions with regard to the diversification of the tax base and/or the functioning of democratic control. Tax bases are more diversified and democratic control is improved in the case of a high share of urban governments, decentralisation is consequently facilitated (see Prud'homme 1995: 359; Thießen 2000: 13).

Beside these two factors, the surveyed authors discuss ethnic fractionalisation, population density, accessibility of natural resources or historical circumstances

as further variables, which have meaningful consequences for the assignment question.

2.2. *The Basic Trade-off and Derivation of an Optimal Degree of Decentralisation*

Figure 1 demonstrates the difficult derivation of an optimal degree of decentralisation because of opposing tensions, which we have described feature-by-feature in Table 1. It becomes clear that the basic trade-off between the realisation of scale effects and the internalisation of externalities, on the one hand, and the consideration of local preferences, on the other hand, creates meaningful tensions, which hamper clear recommendations for the practical assignment of policy tasks. Additionally, inter-jurisdictional competition, politico-economic variables, as well as geographical and demographic general conditions affect these normative assignment recommendations. Table 1 summarises the respective results of various authors and assigns them to the five analysed theoretical features. Apart from mixed suggestions of the reviewed authors *within* these features, pros and cons of a decentralised (or a centralised) government structure are more or less balanced. In this respect, a differentiated case-by-case examination is the only possible solution in order to get satisfactory recommendations for effective assignment problems. Section 4 picks this case-by-case approach up and tries to give policy-specific normative recommendations regarding the optimal assignment to different levels of government.

3. Empirical Review

In the light of the fact that the described theoretical trade-off impedes the derivation of clear and precise recommendations concerning the optimal degree and the effects of decentralisation, empirical analysis gets a crucial role. In this connection we have to question where we can find appropriate data sources, how the degree of decentralisation can be measured and which measure is the most suitable one. By identifying the degree of decentralisation within certain competence fields, we can subsequently describe the distribution of competencies between different levels of government (see Table 4), what is our aim in order to provide normative recommendations for the EU. In this section, Table 3 works as the guiding map and summarises empirical evidence.

3.1. *The Data: Existing Decentralisation Indicators*

We can distinguish three different approaches in the reviewed literature with regard to the measurement of decentralisation. First, they work output-oriented and count

the number of legal, judiciary and other non-binding acts (“policy acts”) per government level. Alesina et al. (2001) choose this new interdisciplinary approach, measured the intensity of the EU in policy-making and developed a certain *de facto* distribution of competencies within the EU. This remarkable result has to be appraised critically: simple quantitative counting of each act does not necessarily inform about its effective impact on the respective policy chapter; the relative importance of EU’s policy involvement cannot be examined, when the respective intensity measures of national and sub-national levels are not considered and, finally, the chosen data base CELEX¹⁰ does not inform how many acts are produced within a certain period – inter-temporal comparisons are not possible (see von Bogdandy et al. 2002: 85).

Second, they work input-oriented and measure the distribution of competencies via input costs of those institutions, which are involved in the execution of the several policy areas and located on diverse government levels. Kramer (2000) follows this concept and examines the public personnel costs in Austria, Germany and Switzerland according to different fields of public functions and different government levels. One could conclude that a certain policy area is more decentralised the higher is the sub-national government’s share of personnel costs in GDP. But this reasoning is blurred on the one hand by difficult methodical selections of different policy patterns in order to retain comparability between various levels of government and between several nation states (see Kramer 2000: 27ff). On the other hand the level of disaggregated personnel costs does not necessarily mirror the *real* distribution of competencies because of diverse salary-structures according to different qualification prerequisites (see the discussion on the quality of governments in Section 2.1.4).

Third, they refer to budget data and approximate the degree of decentralisation using the sub-national government’s (SNG) share of total public expenditures or revenues, respectively, and distinct between different policy chapters (see Oates 1995; Hoeller et al. 1996; Thießen 2000; Letelier 2001; Ebel and Yilmaz 2002; Osterkamp and Eller 2003a, b). These indicators are used in most empirical papers. There seems to be consensus that the share of expenditures of sub-national governments in consolidated government expenditures is the best proxy for the degree of decentralisation. Additionally, self-reliance ratios (share of own revenues of lower levels in their total revenues) and vertical imbalance ratios (intergovernmental transfers as a share of sub-national expenditures) are constructed, in order to examine the independence of sub-national levels. In this context, the Government Finance Statistics (GFS) of the International Monetary Fund (IMF) operate as the data base chosen by most authors.¹¹ The World Bank evaluates the application of the GFS on decentralisation issues (e.g., the lack of details on expenditure autonomy and own-source revenue, deficiencies regarding reported data for the sub-national levels, information scarcity for analysing dispersion among sub-national regions), provides a broad decentralisation bibliography and discusses thoroughly the measurement and adaptability of quantitative as well as qualitative fiscal decentralisation indicators (<http://www1.worldbank.org/publicsector/decentralization>).¹²

3.2. Evidence from Empirical Studies

(a) *Fiscal Decentralisation of Government Activity*: Osterkamp and Eller (2003a) complied with the aforementioned concept of measuring fiscal decentralisation. They analysed total government expenditures of 19 OECD countries (plus Russia) and asked for the share which is spent by sub-central levels of government. This share is then looked at for its development over time. The degree of decentralisation differs widely between the sample. Sub-national tiers of federal countries spend on average more and rely less on central revenues to support their expenditures than unitary ones. Exceptions are the Scandinavian countries (unitary, but high degree of decentralisation) and Belgium (federal, but low degree of decentralisation). Over the past 30 years the share of sub-national levels in general government expenditures has not fluctuated remarkably, nor is there a visible trend. Nevertheless, the article shows considerable structural breaks in France, Norway and Spain.

A second study of Osterkamp and Eller (2003b) decomposes this general degree of decentralisation by different types of government expenditures¹³ and constructs function-specific decentralisation ratios. The policy fields of recreation, culture, religious affairs, housing and community amenities, education, transportation and communication, as well as public order and safety showed the highest functional decentralisation degrees. Even countries which show low general degrees of decentralisation, like France or Luxembourg, exhibit a high decentralisation ratio in these policy fields. Federal countries, on average, exhibit in each of the different fields of activity higher decentralisation degrees than the average of the unitary countries. In the fields of agriculture, public order and education, these differences are specifically pronounced. Asking additionally how the sub-central expenditures are distributed over the different expenditure categories, the article shows that sub-central spending is heavily concentrated on education, social security, health, and housing.

(b) *The Impact of Fiscal Decentralisation on Macroeconomic Indicators*: Several relationships between the degree of FD and macroeconomic indicators are examined in order to test the performance of a decentralised country. These examinations lead to possible answers whether the country could increase its economic performance by centralising or decentralising different policy tasks. Especially the linkages between *economic growth* and the size of the public sector, on the one hand, and the degree of FD, on the other hand, are focused within empirical analysis. It should be stated, that “there is no formalised theory of the relationship between fiscal decentralisation and economic growth” (Thießen 2000: 5). That could really hamper the construction of valuable models and the delivery of satisfactory results. Nevertheless, researchers have put forward the following three hypotheses concerning the relationship between decentralisation and growth: In each of these hypotheses, growth has only a secondary relationship to decentralisation and the nature of this connection – growth-enhancing, growth-impeding, or growth-requiring – depends on what one sees as the primary effects of decentralisation. These primary effects, in turn, have much to do with the specific design of decentralisation policy (Table 2).

Table 2. Three alternative hypotheses explaining how decentralisation can indirectly impact growth.

Hypothesis 1	Decentralisation increases economic efficiency in public spending, therefore its dynamic effects should be growth-enhancing
Hypothesis 2	Decentralisation can lead to macroeconomic instability, which can, in turn, inhibit growth
Hypothesis 3	Developing countries have significantly different institutional and economic environments than developed countries and will not reap the benefits or suffer the consequences of decentralisation in the same ways

Source: <http://www1.worldbank.org/publicsector/decentralization/growth.htm>.

There have been few empirical studies, which have directly examined the relationship between decentralisation and growth. Actually there are only five cross-country studies (Oates 1995; Phillips and Woller 1997; Davoodi and Zou 1998; Yilmaz 1999; Thießen 2000, 2003) and several ones on particular states (e.g., Zhang and Zou 1998 as well as Lin and Liu 2000 on China, Xie et al. 1999 on the USA). These studies tend to be inconclusive and come up with ambiguous results. While Oates (1995) detects a significant and robust positive correlation between FD and growth, Davoodi and Zou (1998) find for the developing countries a negative effect of FD on growth, albeit not significantly, and for the developed countries no clear relationship. Phillips and Woller (1997) concur with Davoodi and Zou (1998) in finding no significant and robust relationship. Yilmaz (1999) finds for unitary countries a positive impact of FD on per capita growth, significant at the 5% level. His results for federal countries are inconclusive. Observing the impacts on growth from the opposite point of view – namely from the centralisation perspective – the results are still mixed: while Behnisch et al. (2001) identify a statistically significant positive effect of overall centralisation on TFP growth in Germany, Schneider and Wagner (2000) find that centralised wage bargaining shows a significant negative impact on long-term economic growth in the EU.

On the one hand these contradictory results can be explained by different methodological approaches and the diverse designs for decentralisation chosen by the authors. On the other hand, the basic theoretical trade-off between the consideration of local preferences (as an argument in favour of decentralisation) and the realisation of economies of scale or the internalisation of external effects (as arguments in favour of centralisation), is in that way confirmed by empirical evidence. Accordingly, the analysis of Thießen (2000, 2003) suggests a hump-shaped relationship between growth and FD (see Figure 2). In the case of too much decentralisation inter-jurisdictional externalities cannot be internalised and economies of scale are not realised; negative growth effects are the consequence. The same holds for a low level of decentralisation: unconsidered preferences lead to inefficiencies in the provision of public goods, what inhibits, in turn, economic growth.

Bearing the fragmentation hypothesis of Section 2.1.4 in mind, we have a strong theoretical argument in favour of a decentralised structure, which strengthens fiscal equivalence and institutional competition, what in turn has limiting effects on the

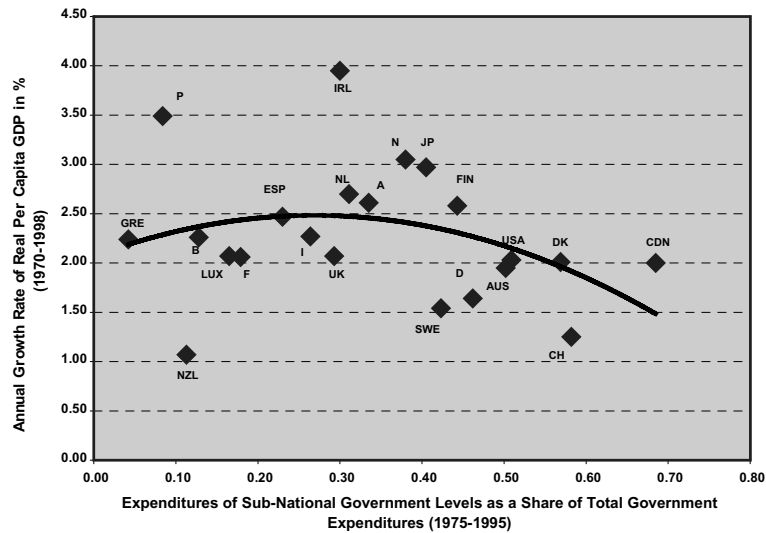


Figure 2. Economic growth versus degree of fiscal decentralisation. Source: Thießen (2000); Data: IMF (International Financial Statistics and GFS).

size of the public sector. This hypothesis has been analysed empirically by many authors in the 1980s (see Table 3). Kirchgässner (2001) reviews their results and concludes that there exists only fragile empirical evidence that fiscal federalism really limits the size of the public sector. This fact can be explained by higher requests of citizens, unrealised scale effects or by an excessive burden to the tax base due to decentralisation (see Kirchgässner and Schaltegger 2002). These “costs” of a federal government structure are reflected also by the impact of FD on the central government deficit. An increasing effect can be detected, especially in the short run (see Fornasari et al. 1999). Conversely, this impact disappears in the long run, what can be interpreted as follows: when a process of FD is in progress, budget costs arise because of the shift of competencies to new authorities and the implementation of new institutions. But bit-by-bit, the efficiency-enhancing effects of decentralisation gain ground, learning effects take place and the initial budget shock loses weight. However, we have to take into account that efficiency gains due to decentralisation can differ remarkably among different policy areas. Each competence field exhibits a diverse structure of local preferences, externalities, institutional competition opportunities and political decision-making. Empirical analysis has so far given little attention to these different structural components and studies regarding particular competence areas are scarce. In this context, *competence-specific analysis* puts its focus mainly on education and health. For example, Letelier (2001) examines the impact of FD on the efficiency of education and public health via data envelopment

Table 3. The impact of decentralisation on macroeconomic indicators.

Authors	Year	Sample coverage: region	Sample coverage: time	Sample coverage: variable	Explanatory federalism variables	Remarks	Method	Investigated links	Major findings
Alesina Angeloni Schuknecht	2001	EU-15	1971–2000	Policy intensity of the EU-level	Number of legal, judiciary and other non-binding acts (“policy acts”) per government level	Sources: TEC, TEU, Steel and Coal and Euratom Treaties, Celex, Court of Justice website	Counting the number of the acts and construction of relative weights across policy domains	<i>Involvement of the EU in policy making</i> : measures of intensity by policy chapter	The data confirm that the extent and the intensity of policy-making by the EU have increased sharply over the last 30 years. The allocation of EU policy prerogatives is partly inconsistent with normative criteria for the proper assignment of policies at different government levels.
Oates	1995	40 countries (no details available)	1974–1989	Average annual growth rate of real GDP per capita	SNG spending as percentage of general government spending; <i>self-reliance ratio</i> of SNGs ^a	Dissertation research performed by Sang Loh Kim and Oates (Maryland)		Impact of FD on <i>economic growth</i>	Significant and robust positive correlation between FD and per capita economic growth. The self-reliance variable is not itself statistically significant, but its first difference is. In the case of developing countries, they appear to respond negatively – albeit not significantly – to FD. When the whole sample is used, this negative effect of FD on growth seems to be more significant.
Davoodi Zou	1998	LDCs and OECD countries (no details available)	No details available	Degree of fiscal decentralisation (FD)		Surveyed in Letelier (2001)	Endogenous growth model		

Schneider Wagner	2000	EU-14 (LU is not included)	1961–1995	Degree of centralised wage bargaining (dummy variable: “1” in the case of centralised bargaining)	Growth regressions with conflict and institutional variables; there is measured – <i>inter alia</i> – the impact of institutional efficiency on economic growth	10-years-moving- average panel with Newey-West estimation procedures	The degree of centralised wage bargaining shows a significant (at the 1% level) negative impact on long-term economic growth. Hint: impact of trans-action and free-rider costs.
Thießen	2000	EU-15, CH, NO, JP, US, CA, AU, NZ, AR, BR, KR, ZA	1975–1995	SNG spending as percentage of general government spending; self-reliance ratio of SNGs	Pure and panel cross-sectional growth regressions	The analysis suggests for high income countries a hump-shaped relation between per capita economic growth and FD.	
Behnisch Buetner Stegaescu	2001	Germany	1950–1990	Total factor productivity growth percentage of general government spending (degree of centralisation)	Growth account- ing procedure	The results indicate a statistically significant positive effect of overall centralisation on TFP growth but not for total public expenditures. Hint: policy co-ordination among different jurisdictions, especially in the context of economic integration among local jurisdictions.	

Table 3. (Continued)

Authors	Year	Sample coverage: region	Sample coverage: time	Dependent variable	Explanatory variables	Remarks	Method	Investigated links	Major findings
Oates	1972	58 countries (no details available)		Tax revenues as a percent of GNP	Central government share in general government current revenues.	Surveyed in Kirchgässner (2001)		Impact of FD on the <i>size of the public sector</i>	The negative correlation became insignificant as soon as GDP per capita into the regression equation is included.
Oates	1985	US states		Tax revenues as a percent of GNP	The number of local government units was included as an additional explanatory variable to measure the degree of fragmentation.	Tests of the fragmentation hypothesis (Brennan and Buchanan 1980)			In the regression together with other explanatory variables only the revenue share got a coefficient which was significantly different from zero and only on the 10 percent level: "there does not exist a strong, systematic relationship between the size of government and the degree of centralization of the public sector" (p. 756).
Nelson	1987			State and local taxes as a fraction of personal income	Average population per general purpose government unit.	Surveyed in Kirchgässner (2001)			Distinguishing between general purpose and single function local units he was able to show that the average population per general purpose local government unit has a positive impact on state and local taxes as a fraction of personal income.

Zax	1989	Aggregate county own-source revenues as a share of county income (self-reliance)	The county share of local total revenue and two different measures of fragmentation, governments per capita and square mile, both for general-purpose and single-purpose governments.	Surveyed in Kirchgässner (2001)	The size of the local public sector increases with increasing centralism and with increasing fragmentation of single-purpose governments, and it decreases with increasing fragmentation of general-purpose governments.
Kirchgässner	2001			Survey of the empirical evidence	here is some evidence that fiscal federalism leads – <i>ceteris paribus</i> – to a smaller size of the government, but the evidence is far from being overwhelming.
Fornasari Webb Zou	1999	Developed countries (no details available)		Surveyed in Letelier (2001)	In the long run, no significant effect of FD can be detected. Nevertheless, in the short run FD clearly increases the central government deficit. Hint: General fiscal imbalance is more likely to arise when a process of FD is in progress.
					Impact of FD on the <i>budget deficit</i>

Table 3. (Continued)

Authors	Year	Sample coverage: region	Sample coverage: time	Dependent variable	Explanatory federalism variables	Remarks	Method	Investigated links	Major findings
Roubini Sachs	1989	OECD countries				Surveyed in Inman/Rubinfield (1992)			OECD countries with decentralised legislatures and more frequent government turnover tend to exhibit larger deficits.
Letelier	2001	~50 countries (no details available)		<i>Outputs:</i> "quality of life" indices regarding education and health	<i>Federalism Inputs:</i> Average share of SNG's expenditures (total, education, health) in the respective total public expenditures; self-reliance ratio	Adjustment by environmental variables that might have some effects on government's performance	Data Envelopment Analysis (DEA)	Impact of FD on the <i>efficiency and public health</i>	FD produces a significant improvement on the efficiency of education. The quality of public health services is improved to a statistically less robust degree.
Fisman Gatti	2000	No details available	No details available			Surveyed in Letelier (2001); Test of Prud'homme's hypothesis (FD as a source of corruption and rent seeking)	Cross-country regressions	Impact of FD on <i>corruption</i>	FD appears to have a negative and significant effect on corruption Hint: improved access of local elite to public resources increases opportunities for corruption (see Dabla-Norris/Wade 2002: 4).

Treisman	2000	154 countries	No details available	Indicators of government quality	Different types of political decentralisation (among them: no. of tiers of government, SN police forces, SN appointment of judges, no. of SN veto players, SN share of government expenditures and tax revenues, SN share of tot. employment in civilian government administration).	The dependent variable is measured by corruption and the effectiveness of healthcare and education services	Cross-country regressions	Impact of FD on <i>government quality</i>	The highest quality governments will tend to occur in less populous countries with unitary states, few tiers of government and relatively large first-tier units, a single centralised police force, and a central legislature in which regional actors do not have veto power (similar, for instance, to Finland or New Zealand).
Huther Shah	1998	80 countries (no details available)	No details available	Composite index of good governance	Degree of FD	Surveyed in Letelier (2001)	The index contains elements of citizen participation, government orientation, social development and economic management	They found a significant and strong relationship between FD and the composite index of "good governance".	

^a Self-reliance ratio of sub-national governments: average share of own revenues of lower levels in their total revenues.

analysis (DEA). He concludes that the efficiency of education is improved significantly by FD, while the quality of public health is improved to a less robust degree. As respects the politico-economic variables, we found empirical studies regarding corruption and “good governance”. The former have just been stressed in Section 2.1.4. As respects the latter, Huther and Shah (1998) construct an index of *good governance*, which contains elements of citizen participation, government orientation, social development and economic management. FD has been used as an explanatory variable for this index. A significant and strong impact of FD on good governance can be found. Again, the theoretical positive effect of a federal structure on the quality of government and on the augmentation of democracy is confirmed.

3.3. *Critical Appraisal*

Despite the intense theoretical debate of the pros and cons of FD, “systematic evidence on the contribution of FD to economic performance is scarce” (Oates 1995: 352). Ambivalent effects are on work, clear recommendations regarding the optimal degree of decentralisation are difficult to draw. This section showed that there is no unambiguous, automatic, relationship between decentralisation and growth. A return to the literature on decentralisation’s primary effects may be a more useful way to think about this connection.¹⁴ What really matters is the adequate design of decentralisation. It is necessary to examine reliable and comparable indicators for federal autonomies. Nowadays there is a lack of thorough cross-country econometric verifications. International comparisons, which modulate the different costs and benefits (e.g., by following the five central features developed in Section 2), could provide a clearer advice regarding the respective federal structure and the optimal degree of decentralisation (see also Eichenberger and Hosp 2001: 88). Furthermore, it is indispensable to extend the prevalent budget data approach by additional methods: two of them are discussed in Section 3.1, further ones can be found in the literature of political science and law.¹⁵ In order to cope with a multi-level government, the exploration of alternative approaches gets a crucial role, because “FD can be observed to have a significant effect on a wider range of variables” (Letelier 2001: 8). Finally, this empirical survey should not only accentuate the extension of the samples and methods, but also endorse long-term analyses.

4. **Application to the European Question: the Integration Process and Open Questions of an Appropriate Assignment of Policy Tasks**

Theoretical features of fiscal federalism are multifaceted and inconclusive, empirical suggestions are ambiguous and policy-specific evidence is scarce. In the light of these facts, this section is confronted with the special challenge to construct the bridge

between general advice regarding the optimal degree of decentralisation and the EU-specific assignment of policy tasks to its different tiers of government.

4.1. *Optimal Distribution of Competencies within the EU: Normative Recommendations*

As we have seen in Sections 2 and 3, the benefits and costs of central versus decentralised functional responsibility describe the trade-off within the cost-benefit-calculus of the vertical division of labour in federal entities (see Thomas 1997: 162). Applying the previous surveyed theoretical and empirical background on the vertical division of labour (i.e., distribution of competencies) within the EU, we can draw a rough picture of an optimal assignment of public services to the various types of authorities. Factors such as economies of scale, economies of scope, cost/benefit spillovers, proximity to beneficiaries, consumer preferences, or flexibility in budgetary choices on the composition of spending, influence these normative recommendations illustrated in Table 4. As respects the competence-specific normative assignment, economists pick the basic trade-off discussed in Section 2 up and concentrate their examination mainly on spillovers, economies of scale and on the structure of local preferences. Politico-economic or geographical variables play an inferior role. Although these variables should enter the *ex ante* calculus, they can be applied to the analysis of discrepancies between the effective distribution and the normative recommendations (see Section 4.3). Different policy domains are distinguished and the respective assignment-recommendations of economists are reviewed in Table 4. These recommendations rely on the theoretical features we handled in Section 2 but also on empirical research. Concerning the delimitation of the chosen functions between the central (EU), the national (Member States) and the sub-national (states, regions, provinces, municipalities) levels, we can sum up meaningful interpretations from this table.

First, the predominant assignment of responsibilities to the EU-level is relatively clear within the areas of external trade, common market, competition policy, monetary policy, defence, foreign affairs, interstate transport and telecommunications. In these areas a provision by the central European level generates normatively higher allocative efficiency because of EoS-realisation, internalisation of externalities, homogeneity of preferences, harmonisation of divergent and distorting national regulations, or avoidance of free-rider effects. Characteristics of pure public goods are detected within these policy areas – sub-central provision of such goods would be inefficient and can therefore be excluded (see Section 2.1). Nevertheless, the recommendation of an *overall* responsibility of the EU does not hold even in these policy areas. According to Shah (2002: 576) we have to distinguish between different functions of policy responsibility, which could be met by only one level, shared by different levels of government or fulfilled also by non-government sectors. He distinguishes (a) policy setting and control, (b) provision and administration, (c) production and distribution. In the case of external trade, for instance, the policy setting

Table 4. Delimitation of competence within the EU: normative recommendations.

Policy domains	Sub-NAT	NAT	EU	CEN	Remarks	Authors
<i>External trade</i>	x	x	X		Benefits and costs international in scope; optional responsibility of SUB-NAT and NAT for provision/administration.	Shah (2002)
			X		International agreements as well as uniform trade and tariff policies with non-member states. Sizeable benefits from free trade at the global level.	Alesina et al. (2001)
<i>Common market</i>		x	X		Natural complement of a common external trade policy. Pro EU: Guarantee of a level playing field for free intra-area trade. Pro NAT: Exaggerated harmonisation could hamper free-area-wide competition.	
<i>Competition policy</i>			X		EU competence in order to promote the functioning of the internal market. Public good argument	Alesina et al. (2001)
				X		Eichenberger Hosp (2001)
			X		Transnational spill-over effects of uncompetitive behaviour or subsidies, distorting effects of different national competition laws.	Hoeller et al. (1996)
			X		Centralisation because of less risk of regulatory capture at the European than at the national level (stronger competition between similar special interests).	Persson et al. (1996)
<i>Money and finance; Monetary policy, Currency, Banking</i>			X		Independence from all levels is essential. Independent Central Bank as main actor.	Shah (2002)
		X	X		• Pro EU: EoS inherent in gathering supervisory information, international spill-overs of financial fragility	Alesina et al. (2001)
					• Pro NAT: fiscal elements built into the provision of lending-last-resort	
					Other issues necessary to take into account: allocation of responsibilities in the light of the OCA-Theory, integration of financial markets, co-ordination of taxation, harmonisation of fiscal policies in the light of the SGP.	
				X	Benefits for all citizens, homogeneity of quality and execution ("poor public goods").	Smekal (2001)

<i>Industry, Energy</i>	X			To avoid beggar-thy-neighbour policies.	Shah (2002)
<i>Agriculture</i>	X			There are not provided any public goods in the classical sense: moreover, these sectoral policies could hamper the completion of the internal market.	Alesina et al. (2001)
	X			The move towards greater reliance on market forces makes the rationale for pursuing agricultural policy at the EU level less evident.	Hoeller et al. (1996)
<i>Defence, Foreign affairs</i>	X	X		Benefits and costs national in scope	Shah (2002)
			X	Significant EoS and externalities to be exploited, provided geo-political interests are similar.	Alesina et al. (2001)
			X	A clear case for centralised provision can be made – at least on allocative grounds – only for national public goods.	Ter-Minassian (1997)
			X	EoS (lower negotiation and decision-making costs), indivisibilities (minimum size of an army), avoidance of free-riding, relatively homogeneous preferences.	Hoeller et al. (1996)
<i>Consumer protection, Internal security</i>			X	Benefits for all citizens, homogeneity of quality and execution (“poor public goods”).	Smekal (2001)
<i>Infrastructures for interstate transport and telecommunications</i>	X	X	X	Benefits and costs of various roads vary in scope. Provision/administration and production/distribution by non-government sectors.	Shah (2002)
			X	Public good argument: EU wide transportation and communication networks.	Alesina et al. (2001)
			x	Centralisation in this policy area showed a statistically weak positive effect on growth.	Behnisch et al. (2001)
			X	A clear case for centralised provision can be made – at least on allocative grounds – only for national public goods.	Ter-Minassian (1997)
<i>Regional / Social Policy, Employment, Business development</i>	X	X	x	Pro EU: Guarantee of high standards of social protection, distributional reasons. Pro NAT/SUB-NAT: Predominant weight of heterogeneous local preferences and backgrounds.	Alesina et al. (2001)

Table 4. (Continued)

Policy domains	Sub-NAT	NAT	EU	CEN	Remarks	Authors
	X				Heterogeneous execution (consideration of individual local preferences) is possible, strong service-orientation in the case of personal demands, direct and indirect inter-jurisdictional competition effects.	Smekal (2001)
	x			X	Pro CEN: a) Risk-pooling (social insurance mechanisms against life-cycle and economic contingencies) b) ensuring nationwide-standards for social insurance Pro SUB-NAT: delivery of social assistance for administrative efficiency reasons; CEN sets standards.	Ter-Minassian (1997)
	x	x	X		Pro EU: risks of harmful "social dumping" between MS (via asymmetric reduction of labour costs). Pro SUB-NAT/NAT: dilution of labour market constraints (e.g., working hours, minimum wages, opening hours) by regulatory competition.	Persson et al. (1996)
<i>Environment</i>	X	X	X		Externalities of global, national, state and local scope.	Shah (2002)
	X	X	X		Pro EU: EU-wide externalities, EoS, consideration of fix costs (e.g., research). Pro NAT/SUB-NAT: The preservation of territory and the enforcement of environmental policies are likely to have a strong local component.	Alesina et al. (2001)
	X	X	X		Pro EU: distortions of competition because of disparities between national environmental standards, effluent taxes or subsidies to tackle environmental problems. Pro NAT/SUB-NAT: existence of local environmental externalities with no cross-border spill-overs; a central setting of undifferentiated standards could be inefficient.	Hoeller et al. (1996)
<i>Education, Research, Culture, Health</i>	X	x			Transfers in kind. Shared responsibility of SUB-NAT and NAT for policy standards and oversight.	Shah (2002)
	X	X	X		Pro NAT: Potentially large externality element, knowledge spill-overs across frontiers. Pro SUB-NAT: Predominant weight of local preferences and backgrounds.	Alesina et al. (2001)

X	FD produces a significant improvement on the efficiency of education. The quality of public health services is improved to a statistically less robust degree.	Letelier (2001)
X	Heterogeneous execution (consideration of individual local preferences) is possible, strong service-orientation in the case of personal availment, direct and indirect inter-jurisdictional competition effects.	Smekal (2001)
x	In the case of an adverse effect of sub-national provision on the stock of human capital, there can be significant efficiency costs from decentralisation. Inefficiencies because of overlapping or duplication of health services in the case of local health care provision. Co-operation of MS in order to avoid duplication and to overcome imperfections, when high-risk capital is involved, when R and D costs are high and when EoS play a role.	Ter-Minassian (1997)
X		Hoeller et al. (1996)
X	Pro NAT/SUB-NAT: The direct cross-national externalities in Europe are not likely to be large enough in order to motivate centralisation. Pro EU: Enforced teaching of European topics (e.g., foreign languages) fosters greater labour mobility in Europe and supports positive integration effects.	Persson et al. (1996)

Note: Sub-Nat: sub-national (local, state, regional or provincial) level, NAT: national level (EU-Member States), EU: supranational level (European Union). In the case of no explicit distinction between national and supranational level: CEN (central level). A "X" stands for unreserved responsibility of the respective level; a "x" stands for supporting/complementary involvement of the respective level. In the case of more "X", the respective levels share the responsibility.

function should only be met by the supranational level, the functions of provision and administration should be shared by supranational, national as well as state/provincial governments; non-government sectors could take care of production and distribution. Other exceptions from the unambiguous assignment of the aforementioned policy tasks to the EU-level exist in the area of common market, where exaggerated harmonisation could hamper free-area-wide competition (see Alesina et al. 2001: 6) – and in the area of defence, where Shah (2002) classifies benefits and costs (arising from externalities and EoS) only national in scope.

Second, we can filter out policy areas, where the responsibility should be assigned primarily to the national and/or to the sub-national government. As regards industry, energy or agriculture, the assignment to the national level is explicitly recommended. In this context, the authors do not refer as usual on spill-over or preference views, but on pragmatic arguments. In the case of agriculture, Hoeller et al. (1996: 29) do not see any rationale for pursuing agricultural policy at the EU-level because of moves towards greater reliance on market forces. Sectoral policies could provide public goods, for example, if they support an EU-wide transportation and communication network. However, Alesina et al. (2001) cannot detect such a provision of public goods by the mentioned policy areas. Even, they see the danger, that these policies (in particular energy) could delay the completion of the internal market, when assigned to the EU-level.

Third, there exists a group of competencies, where the assignment to only one level of government is not optimal. Environment is such a policy field, where the responsibility should be shared between different levels. On the one hand, scale effects as well as the setting of EU-wide environmental standards in order to avoid distortions of competition require a meaningful involvement of the Union (see Sinn 2003). According to Bureau and Champsaur (1992: 89), competition distortion constitutes the main externality justifying a corrective centralised intervention. On the other hand, various externalities take effect on different levels and their influence is likely to be limited on the respective jurisdictional size, what, in turn, calls for a decentralised execution. Thus, the specification of the extent to which this function should be shared between the different levels could be difficult. A widespread examination is necessary.

Fourth, there remain policy chapters where the optimal assignment is discussed contradictorily by the various authors, depending on the research focus they have chosen. Education and research, on the one hand, and social policy, on the other hand, are such examples. In the former case, the ones found remarkable arguments for a decentralised assignment: consideration of heterogeneous local preferences, effects of inter-jurisdictional competition, or limited cross-national externalities (see Persson et al. 1996; Alesina et al. 2001; Smekal 2001). The others, in turn, depict strong reasons in favour of an assignment to the central European level: adverse effects of sub-national provision on the stock of human capital (Ter-Minassian 1997), avoidance of R&D-duplication (Hoeller et al. 1996), or increase of EU-wide labour mobility due to enforced teaching of European subjects (Persson et al. 1996). As respects social policy, local preferences and inter-jurisdictional competition are

stated as arguments in favour of decentralisation again (Alesina et al. 2001; Smekal 2001). Additionally, the improvement of administrative efficiency and the fact of a low level of mobility, which limits spillovers (see Hoeller et al. 1996: 38), strengthen decentralised responsibility. But there exist also valuable reasons for a central assignment. Ter-Minassian (1997) discusses the effects of social risk-pooling at the central level and perceives the importance of a central guarantee of nationwide-standards for social insurance. Persson et al. (1996) supplement this position by their politico-economic point of view – they advise a strong role of the EU because of the danger of social dumping between MS. Despite this centralisation recommendation, they recognise also the dilution of rigid labour market constraints by regulatory competition, which, in turn, calls for decentralised responsibility.

As in the general discussion of optimal decentralisation in Section 2, the policy-specific normative recommendations are multifaceted and in part contradictory. An unambiguous assignment is difficult to implement. This fact requires further research efforts. To begin with the presented assignment scheme (Table 4), some fine-tuning is necessary. According to Shah (2002) the distinction between different government levels has to be extended by further institutional and non-government tiers in order to consider privatisation effects. In this connection, the adequate delimitation of the public sector has to be discussed. This extended disaggregation holds also for the mentioned policy functions. Within R&D, for example, there exist several topics where the exclusive concentration on the central level seems to be more appropriate. Nuclear research could be such an example. Last, but not least, this assignment-approach has to be supported by reliable empirical conclusions. As we saw in the case of education, the opposing assignment-discussion is clarified by the strong empirical indication of a decentralised education structure (see Letelier 2001).

4.2. Actual and Prospective Distribution of EU-competencies: Discussion within the European Convention

While the previous section has summarised normative recommendations for an optimal assignment of competencies based on opinions of economists, this section focuses on the distribution in the EU. We refer mainly to documents of the debate within the European Convention. The Praesidium, the Working Group “Complementary Competencies” (WG V) and indirectly also the Working Group “Subsidiarity” (WG I) dealt with the appropriate delimitation of competencies between the EU and the MS. In a first step, the Praesidium of the European Convention tried to describe the actual delimitation of competence between the EU and the MS, distinguishing between legislative and non-legislative categories (see European Convention 2002, CONV 17/02). In a second step, they assigned concrete policy domains to the legislative category. We can classify three main types of (legislative) competence conferred upon the Union: exclusive (where the internal market gets a special role), shared and complementary ones (see European Convention 2002, CONV 47/02: 6ff). In a third step, the Working Group V dealt with the implementation of the

competence chapters in the future Treaty, with the specification of the mentioned types of competence, and especially with the role of complementary competencies, which are called “supporting measures” (see European Convention 2002, CONV 375/1/02). It is noteworthy that there are valuable discrepancies between the Praesidium’s report (European Convention 2002, CONV 47/02) and the final report of WG V (European Convention 2002, CONV 375/1/02). The latter classified development co-operation and customs co-operation as shared competencies, while the former identified them as complementary ones. Furthermore, the WG V did not take care of economic policy (co-ordination) or defence, which are also classified as complementary competencies by the Praesidium. Rather, they refer implicitly to the Working Groups “Economic Policy” (WG VI) and “Defence” (WG VIII). In this context we would like to draw attention to Pernice and Constantinesco (2002), who add a fourth type of competence, namely the “common co-ordination competence” (co-ordination by the Council, administrative/assisting function of the Commission or the Council, respectively), where the co-ordination of economic policy is included. In a final step, the “Draft Treaty (DT) establishing a Constitution for Europe”, adopted by consensus by the Convention on 13 June and 10 July 2003, and its elaborated Title III “Union Competencies” of Part I (see European Convention 2003, CONV 850/03) specifies the three categories of Union’s competencies and state for each category what the consequences of the Union’s exercise of its competencies are for the competencies of the MS. The category of “supporting measures” have been renamed again – their final denomination: “supporting, coordinating or complementary action” (Article 16 DT). In contrast to the final reports of the working groups, the co-ordination of economic and employment policies has been separated out from “supporting measures” and the Common Foreign and Security Policy (CFSP) has been separated out from “shared competence” by drafting specific Articles (Art. 14-15 DT). Table 5 provides a respective overview. Comparing the final draft with earlier proposals of the Convention (especially with the Praesidium’s report on the “Delimitation of competence between the European Union and the Member States” (European Convention 2002, CONV 47/02, May 2002), with the final report of WG V (European Convention 2002, CONV 375/1/02, November 2002) and with the Praesidium’s “Draft of Articles 1–16 of the Constitutional Treaty” (European Convention 2003, CONV 528/03, February 2003), remarkable shifts and amendments can be detected – in part reflecting the discussion process within the Convention and in part revealing the Praesidium’s “handwriting”. Without analysing these shifts and their implications in detail, we would like to emphasise two essential points.

First, the contradictory and special case of the internal market has to be pointed out at this stage. Following the Praesidium’s proposal of May 2002, the internal market has been classified as a special kind of “functional” competence for the harmonisation of legislation by the Union, where MS retain competence in some areas (see European Convention 2002, CONV 47/02: 6f). Furthermore, the February-proposal of the Praesidium classifies ensuring the four freedoms as an area of exclusive competence of the Union. At the same time the internal market, which

Table 5. Prospective delimitation of competence within the EU.

Categories of competence	Policy domains	Remarks (Art. 11 DT)	MS	EU
Exclusive competence of the Union (Art. 12 DT)	(a) Establishment of competition rules necessary for the functioning of the internal market (b) Customs union, common commercial policy, monetary policy, conservation of marine biological resources Principal areas: Internal market; area of freedom, security and justice; agriculture and fisheries; transport; trans-European networks; energy; social policy; economic and social cohesion; environment; common safety concerns in public health matters; consumer protection	Only the Union may legislate and adopt legally binding acts, MS may only act in such fields if authorised by the Union or for the implementation of acts adopted by the Union		X
Shared competence between the Union and the Member States (Art. 13 DT)		The Union and the MS shall have the power to legislate and adopt legally binding acts. The MS shall exercise their competence to the extent that the Union has not exercised, or has decided to cease exercising, its competence. The scope is specified in Part III DT	X	X
Co-ordination of economic and employment policies (Art. 14 DT)	Research, technological development and space, development co-operation, humanitarian aid	The exercise of that competence by the Union may not result in MS being prevented from exercising their competence The Union shall adopt measures to ensure coordination of the economic and employment policies of the MS, in particular by adopting guidelines for these policies. The MS shall coordinate their economic policies within the Union	X	x

Table 5. (Continued)

Categories of competence	Policy domains	Remarks (Art. 11 DT)	MS	EU
Common foreign and security policy (Art. 15 DT)		MS shall actively and unreservedly support the Union's CFSP in a spirit of loyalty and mutual solidarity and shall comply with the acts adopted by the Union in this area. They shall refrain from action contrary to the Union's interests or likely to impair its effectiveness	x	X
Supporting, coordinating or complementary action (Art. 16 DT)	Industry; protection and improvement of human health; education, vocational training, youth; culture; sport; civil protection	The Union shall have competence to carry out actions to co-ordinate, supplement or support the actions of the MS, without thereby superseding their competence in these areas	X	x
Member State's Competence (Art. 9(2) DT)		Legally binding acts adopted by the Union cannot entail harmonisation of Member States' laws or regulations The scope is specified in Part III DT Competencies not conferred upon the Union in the Constitution remain with the Member States	X	

Source: Draft Treaty (DT) establishing a Constitution for Europe, Part I, Title III (CONV 850/03, July 2003).

Note: MS: EU-Member States, EU: supranational level (European Union). A "X" stands for unreserved responsibility of the respective level; a "x" stands for supporting/complementary involvement of the respective level. In the case of more "X", the respective levels share the responsibility.

embraces the four freedoms by definition, is allocated to the category of shared competence (see European Convention 2003, CONV 528/03: 7). In the light of these inconsistencies, this proposition has been discussed very controversially by lawyers and politicians. In March 2003, Dougan (2003: 8), for example, pointed out that this proposition is “perhaps the single most glaring legal shortcoming of the current text” and he consequently criticised that “the Praesidium approach is thoroughly inconsistent with traditional academic analysis that free movement should rightly be seen as an area of shared competence.” As a consequence of vehement protests, the final draft does not assign the four freedoms to a specific competence category anymore.

Second, similar critical remarks appear with regard to establishing competition rules necessary for the functioning of the internal market. Contrary to CONV 47/02 or to the final report of WG V, Article 12(1) DT codifies competition policy as an area of exclusive Union competence. Dougan (2003: 8) analyses the application of Articles 81 and 82 TEC and the respective decisions of the European Court of Justice and comes to the result that “neither situation can really be described as one of exclusive Union competence”. The inclusion of competition policy within the areas of exclusive competence is an apparent failure to understand the current legal position and can only be explained by the tendency within the Convention to expand areas of exclusive competencies.

4.3. Comparison of Normative Recommendations with the Actual and Prospective Distribution of Competencies

Comparing results from Section 4.1. (based on the conclusions of economists) with those from Section 4.2. (based on the conclusions of lawyers and politicians), we have to bear in mind that they are using a different terminology for competence matters. On the one hand, economists focus their assignment analysis mainly on spillovers, economies of scale and on the structure of local preferences and ask for optimal assignment *and* execution of various policy fields by the respective levels of government. On the other hand, the lawyers’ analysis relies primarily on the elaborated categories shown in Table 5, and asks for the assignment of various policy tasks (mentioned in the existing Treaties, secondary legislation or Court decisions) to these specific categories. Thus, the following comparison is likely to be distorted, if the normative recommendations of economists mixed up matters of assignment and execution (like Shah 2002) or different competence classifications were used. There exist, for instance, different understandings regarding the category of exclusive competencies, where economists talk about “predominant” assignment of responsibilities to the EU-level, whereas lawyers exclude any action of MS, unless explicitly admitted by the Union. Similar notions hold for the category of shared competencies, where the preempting effects within the juridical definition are not adequately considered by economists. In this way, the legal reality of the European Union is not sufficiently reflected by economists. Furthermore, policy tasks are assigned based on the trade-off between centralisation and decentralisation, which has its foundations

mainly in the nation's state analysis. A more specific application of fiscal federalism on EU competence categories, classified by lawyers and politicians, has to be strongly recommended in order to allow for more realistic and sophisticated normative *de facto* comparisons.

Comparing Table 4 with Table 5, we can distinguish policy domains, where the actual and prospective distribution (or more precise: "the distribution proposed by the European Convention") corresponds more or less to the normative suggestions, and functions, where remarkable discrepancies exist. To begin with the former ones, *monetary policy, transport and environment* seems to correspond more or less to the normative advice.

As regards *regional/social policy and employment*, where we found contradictory normative positions, the actual and prospective distribution does primarily correspond to the recommendations of Alesina et al. (2001) and Persson et al. (1996); in fact, also Ter-Minassian (1997) suggests a kind of shared competence in the area of social policy. However, we could ask, whether the respective responsibility of the EU should be extended in the future. Hoeller et al. (1996: 38) do not see the need for more centralised decision-making regarding social expenditures because of the low level of mobility, which limits spill-over effects from fiscally induced migration.

The distribution by level in the area of *education* does correspond mainly to the advice of Persson et al. (1996). But on the one hand, education as a supporting measure does not reflect the theoretical reflections of duplication and adverse effects on the stock of human capital. On the other hand, the strong normative reasons for a sub-national involvement in this policy area are not considered in the actual Treaties. There arises the question whether the right of transnational collaboration between regions should be implemented in the future Constitution (as claimed, e.g., by Fischer 2002: 5).

Remarkable discrepancies between the actual and prospective distribution and the normative suggestions can be detected in the areas of *agriculture* and *defence*. On the one hand, the very extensive competence of the Community in the area of agriculture is not supported by theoretical analysis (see Hoeller et al. 1996). On the other hand, defence is one of the public goods where externalities of decisions are strongest – a central provision is therefore strongly recommended. Defence has been classified as a topic of supporting measures in CONV 47/02, while the DT does not refer anymore explicitly to Common Defence Policy. However, Persson et al. (1996: 4f) call for an appropriate institutional mechanism to enforce the centralised solution. Otherwise, simple co-ordination between MS fails because of free-rider effects. They explain the lack of adequate assignment to the central European level via divergences in policy preferences: "a delegation from national to European policymaking bodies of the authority to decide how to use [common] troupes [...] [seems] to be too risky at the present stage of integration" (Persson et al. 1996: 5). This explanation of Persson et al. reflects the contentious transfer of national sovereignty regarding defence and foreign policy to the EU-level and is endorsed by the collapse of CFSP during the Iraq-War in spring 2003. The respective incapability of action by the Union

showed on the one hand the necessity to cope definitely with the normative centralisation advice. On the other hand the vagueness and the lacking commitment of Title V TEU (see also Article 15 DT) are demonstrated conspicuously in this way.

This brief comparison shows that adaptations of the European distribution of competencies are necessary in order to reach entirely the normative benchmark. In addition to the critical preliminary remark we can ask now, how valuable is the chosen approach and how reliable is the normative benchmark for the European case. First, the normative *de facto* comparison holds more or less only under valid premises of the theory of fiscal federalism and the referring experiences in existing federal states. But there are many specificities in the prefederal structure of the EU, which limit the applicability of fiscal federalism: small budget of the EU relative to the MS, lack of provision of core public services (e.g., defence), high degree of heterogeneity in preferences for core public goods, lack of flexibility to pursue macroeconomic stabilisation objectives (see Hoeller et al. 1996: 5ff). Thus, the *sui generis* character of the EU could really distort the proper adjustment of the mentioned discrepancies. Second, the necessary fine-tuning of Table 4 has also to be extended to Table 5: in part, the function-level-assignment is vague and should be made concrete by additional tiers of government and by a disaggregated function structure (see, e.g., Hoeller et al. 1996: 29ff, who attempt to analyse “spending under the umbrella of the community” function-by-function). Third, despite the normative basis, different historical, institutional, administrative or political circumstances lead to varying practices with respect to the choice of functions to be covered by each level of government (see Ter-Minassian 1997: 6).

To sum up, to give a satisfactory answer to the question “What *should* and what *does* the European Union really do?”, only a multidimensional and differentiated approach can succeed. Considering the existing discrepancies between the normative and the actual/prospective situation and taking the aforementioned critical remarks into account, it is evident to enlarge our point of view: the delineated static assignment of competencies should be extended by a dynamic perspective, by a procedural approach. The following final section picks this perspective up and discusses it in the light of the Convention process.

4.4. Procedural and Institutional Suggestions

An adjustment of the competence-distribution process should be the main feature of any reform of competencies within the EU (see Henke and Perschau 1999).

“The existing EU charters fall significantly short of providing a method – let alone a detailed road map – for assigning policy prerogatives among supranational, national and local policy authorities in the continent. Providing a rationale for this is a key ingredient of any ‘constitutional phase’ for Europe.” (Alesina et al. 2001: 1)

These statements endorse our final focus on the procedural aspects of competence allocation within the EU. Over time public goods experience variability in their spatial characteristics. Innovations, technical adjustments and unstable local preferences change cost functions and require consequently dynamic responses within the competence distribution scheme.

“Given the diversity in Member countries’ interests and histories and the fact that the costs and benefits of public policies can vary widely in such a large economic area, only flexible arrangements will allow economically sound progress in the deepening and widening of the EU.” (Hoeller et al. 1996: 36)

Or as Rose and Traut (2001: 3) put it, “Federalism requires permanent evaluation and readjustment according to the changing shape of a society and the new challenges that it faces as it evolves”. Only a flexible process of competence distribution can guarantee proper reactions on changing general conditions. In this context, they have to consider the prerequisites of distortion-avoidance and reversibility (see Heinemann 1995). A distribution process is distorted, when influenced remarkably by vested political interests, and irreversible, when not able to react on changing general conditions. Therefore, the development of a dynamic scheme is a special challenge for constitutional designers. The debate within the Convention has been well referring to this necessity and detected a certain trade-off between the demand for flexibility and the demand for precise delimitation (see European Convention 2002, CONV 47/02: 11). In this context, the composition of task lists or competence catalogues, respectively, is discussed controversially. On the one hand, a task list has the advantage of more transparency and clarity. On the other hand a task list included in a future Constitution, seems to be very rigid and does not correspond to the precondition of a flexible and reversible system (see European Commission, COM [2002] 247: 22). This rigidity would be confirmed, first, when the various policy domains are assigned explicitly to the three types of competence and included with them in the future Constitution, and second, when the revision of the Constitution will be confronted with an exhausting procedure.

From the actual point of view, this fear can be confirmed. In fact, the final Draft Treaty of the Convention and the elaborated Articles 11 to 16 DT (Part I) intend to codify specific areas of the three different categories of Union competence. The DT is subdivided into four parts: (I) constitutional structure, (II) the charter of fundamental rights of the Union, (III) the policies and functioning of the Union, and (IV) general and final provisions. Although the February-proposal of the Praesidium emphasises the “Convention’s wish not to establish a fixed catalogue of competencies” (European Convention 2003, CONV 528/03: 15), the Articles 12, 13 and 16 indicate explicitly areas of exclusive and shared competence and areas in which the Union supports or co-ordinates actions by the MS. At first glance, the “reference in Article 13 to ‘principal areas’ avoids having to define in detail each area of shared competence” (European Convention 2003, CONV 528/03: 15). But it is obvious that

the link to the specific provisions of Part III, which determine the extent and intensity of Union competence in each area (shared competencies and supporting/co-ordinating/complementary action), does even enforce detailed regulation. The respective feared rigidity has to be evaluated in the light of the revision procedure of the Treaty establishing the Constitution as a whole and concerning the revision of the singular Parts of the Treaty.

Draft Article IV-7 specifies the procedure for revising the Treaty establishing the Constitution. The European Council will play the crucial role in this context. After consulting the European Parliament and the Commission, the European Council shall either convene a Convention in order to examine the proposed amendments (codification of the “Convention-method”) or define the terms of reference for an intergovernmental conference (if the convocation of a Convention is not justified by the extent of the proposed amendments). The European Parliament has to agree to the decision not to convene the Convention. Earlier proposals of the European Convention discussed the possibility that “certain provisions might stipulate that they may be amended by the Council or the European Council, by unanimity or qualified majority” (European Convention 2003, CONV 647/03: 13). But according to Article IV-7 amendments will only be determined if the intergovernmental conference will accept the recommendations of the Convention or decide own adaptations by “common accord” (what means, in fact, unanimous decision-making). Furthermore the amendments will only enter into force after being ratified by all the Member States.

In the light of this very exhaustive revision procedure (accordance between the European Council, the European Parliament and the Commission; convocation of a Convention; intergovernmental conference with unanimous decision-making; ratification by all Member States) and combining it with the aforementioned catalogue-discussion, the prerequisite of reversibility cannot be met sufficiently. This conclusion is endorsed by the fact that different revision procedures are not proposed for the three parts of the Treaty. Part III specifies the extent and intensity of Union competence in the case of shared competencies and supporting action in a very detailed way and the same revision procedure as for Part I applies – rigidities are built in.

(a) *Shared competence and inherent flexibility*: The Member States can legislate autonomously in the field of shared competence, provided the Union has not exercised its regulatory power. Once the Union has enacted legislation, secondary law prevents the MS from adopting different rules (see Von Bogdandy and Bast 2002: 242). If general conditions change, the abolition or the adaptation of the act of secondary law will enable to shift responsibility from the Union to the MS. “The Member States shall exercise their competence to the extent that the Union has not exercised, or has decided to cease exercising, its competence.” (Article 11(2) DT). One could argue that this provision guarantees enough flexibility for proper competence-reallocation. This conclusion is blurred by the fact that a qualified majority or even unanimity of the Council is required to amend or abolish a legislative act. Von Bogdandy and Bast (2002: 246f) detect respective rigidities and refer to agri-

cultural policy, where renationalisation-attempts and changes of the market organisation failed due to decision-making problems. They recommend to relax the conditions under which a legislative act under a shared competence can be abolished and advocate less strict majority rules for the abolition than for the adoption of the legislative act. Similar recommendations are discussed by WG V of the Convention with regard to the design of a flexibility clause included in the future Constitution.

(b) *Flexibility clause*: The application of Article 308 TEC¹⁶ is discussed controversially. The ones fear that it opens a door for unjustified centralisation and advocate its deletion. The others recommend that this article should be maintained to provide a necessary measure of flexibility in the Treaty system of competence (see European Convention 2002, CONV 375/1/02: 14). However, the final report of WG V proposes a new regulation for this article. On the one hand, they favour a specific provision enabling a qualified majority to repeal acts adopted under Article 308. This allows restoring freedom of action to the MS. Changing general conditions can be considered in this way. On the other hand, they recommend that unanimity in the Council should continue to be required under Article 308. Consequently, the transfer of new competencies to the EU-level – in the course of the operation of the common market – is hampered remarkably in a future Union of 25 MS. Although Article 308 is not a provision, which regulates the distribution of competencies *ipso jure*, it affects the flexibility of the distribution-process in an asymmetric way. Therefore, undesirable distortions are the consequence if the respective recommendations of WG V are included in this way in the future Constitutional Treaty. Article 17 DT (Flexibility clause) will succeed Article 308 TEC and does not refer anymore to these asymmetric majorities between adoption and repeal of acts. Nevertheless, Article 17 shows restricting elements if its provision may be used only “within the framework of the policies defined in Part III”.

(c) *Sunset legislation*: In order to respond rapidly and effectively on the demands of the real world the introduction of a new type of “delegated” act is proposed by the Working Group “Simplification” (WG IX). In this context sunset clauses are planned as control mechanisms with limited duration; “once the deadline has passed, the delegation of powers would have to be renewed by the legislator” (European Convention 2002, CONV 424/02: 11). This proposal has strongly to be approved and should be extended to the regulation of a whole competence area. Assigned competencies with limited duration create continuous pressure of probation and substitute lacking inter-jurisdictional competition pressure (see Henke and Perschau 1999). Furthermore, sunset legislation corresponds to the prerequisite of reversibility because a permanent centralisation of various functions is prevented. We can find examples for existing sunset laws in Switzerland, where the federal government’s right of levying own income and value-added taxes ends after 10 years and has to be confirmed by a referendum afterwards (see Eichenberger and Hosp 2001: 99).

(d) *Onus of proof*: In order to live up to the principle of subsidiarity and its primacy of decentralisation, proponents of centralisation should bear the onus of proof in the case of intended shifts of competencies (see Thomas 1997: 177; Färber 2001: 133f). From the economic point of view, this requires the verification of sig-

nificant welfare-improvements due to centralisation. Otherwise no shifts should take place. Thus, it would be necessary to include a respective section in the future Constitutional Treaty. The “Protocol on the Application of the Principles of Subsidiarity and Proportionality” (see European Convention 2003, CONV 850/03: 229) picks this necessity indirectly up and recommends the composition of a “subsidiarity sheet” which should be attached to any legislative proposal of the Commission and should contain some assessment of its financial impact. Nevertheless, neither the coverage nor the binding character of this “financial impact” are already specified.

(e) *Control mechanisms*: Not only the distribution process but also the control of competencies has to be discussed regarding its efficiency effects. Following Mueller (1997: 270f), the establishment of a special federalist court charged with the responsibility for preserving European federalism and settling jurisdictional disputes is a crucial safeguard against the overcentralisation of government activities.¹⁷ Does the European Court of Justice in its present structure correspond to such a federalist court? The ones criticise that the Court judges too centralisation-friendly and claim therefore the institution of a new judicial body, which settles exclusively competence disputes (see Henke and Perschau 1999). The others do not agree that the establishment of new institutions increases efficiency and/or legitimacy of dispute settlement (see Fischer 2002: 6). In fact, Fischer (2002) calls for an upgrading of the Court of Justice to a *real* Constitutional Court and advocates *ex ante* monitoring of subsidiarity through this Court. Nevertheless, following the “Protocol on the Application of the Principles of Subsidiarity and Proportionality”, *ex ante* control should be of political nature, whereby the national parliaments are involved in the context of an “early warning system”. *Ex post* monitoring should be of judicial nature. Discussing the deficiencies of actual judicial control, we have also to pick up the debate regarding the European Court of Auditors. This Court is still dependent of Member States’ agreement, when examining the accurate usage of transfers from the EU to national budgets (see Färber 2001: 127). As this examination gives crucial information regarding the competence exercise at different European government levels, a respective revision should be debated.

5. Summary and Concluding Remarks

How can policy tasks be assigned optimally to different levels of government? What effects play a crucial role? How can we evaluate the economic effects of a decentralised government structure? What normative recommendations hold for the delimitation of competencies within the European Union? To what extent did the European Convention consider arguments of efficiency and flexibility in its competence debate? How shall the normative benchmark be defined and to what extent are procedural and institutional aspects decisive? These questions suggest an interesting research agenda. We can summarise the results as follows:

(i) The theory of fiscal federalism delivers a broad basis in order to analyse the optimal assignment of policy tasks. We have detected five different theoretical fea-

tures of fiscal federalism, which affect decisively the assignment-question: consideration of local preferences, realisation of economies of scale and internalisation of externalities, inter-jurisdictional competition and vertical division of labour, politico-economic variables, geographical and demographic variables. These features are multidimensional and, in part, contradictory. A concrete derivation of an overall optimal degree of decentralisation is not possible because of opposing theoretical arguments. Pros and cons of a decentralised government structure are more or less balanced. Therefore, the adequate degree of decentralisation has to be detected in a task specific manner, following a case-by-case approach. With regard to multifaceted interdependencies within and between the stated theoretical features, further work on the theoretical front is necessary in order to value more clearly the effects of practical decentralisation decisions.

(ii) The performance of a federal structure can be evaluated by examining its effects on economic growth, on the size of the public sector, on corruption or on efficiency improvements within specific policy fields. Systematic evidence on direct relationships between economic performance and fiscal decentralisation as well as task-specific evidence is ambiguous and scarce. There is a lack of thorough cross-country econometric verifications. One outstanding task is the adequate measurement of decentralisation – substantial investment in data collection is required in order to construct reliable and comparable indicators for federal autonomies. But it is also necessary to dig deeper into institutional details and to engage in long-term analysis.

(iii) On the basis of theoretical and empirical suggestions, the construction of a normative assignment scheme for the European Union is possible. Comparing the actual delimitation of EU-competencies with the normative recommendations, the areas of monetary policy, transport and environment seem to correspond more or less to the normative advice, while remarkable discrepancies arise in the fields of agriculture and defence. Discrepancies to a lesser extent can also be detected in the areas of social policy, employment, industry, energy and education. However, a fine-tuning of the categories is necessary in order to cope with different functions of policy responsibility, with additional institutional and non-government tiers, or with disaggregated policy functions. Only a multi-dimensional, differentiated and interdisciplinary approach can succeed. This examination is possible, if lawyers, political scientists and economists co-operate. This article is intended to encourage such co-operative attempts.

(iv) In order to achieve the delineated normative benchmark, considerable changes of the actual European distribution scheme would be necessary. In the case of such incisive recommendations by the European Convention, an affirmation by the 2004 EU Intergovernmental Conference cannot be expected (see Vaubel 2002: 640). Nevertheless, from our point of view it is not so important which policy functions are allocated to the different tiers of the EU at present – it is more decisive what kind of competence distribution process will be included in the future Constitutional Treaty. In fact, codified procedural aspects decide the future assignment permanently. Will they build in enough flexibility in order to react to changing conditions? Or will the constitutional codification of precise tasks hamper the reversibility of the assignment

scheme? How rigid will the revision procedure of the Treaty be? A well-elaborated design of the flexibility clause, the establishment of sunset legislation, the endorsement of bearing the onus of proof by proponents of centralisation, the development of a reversibility-guaranteeing revision procedure, or the reform of competence-dispute settlement and recognition of judicial control are necessary elements of flexible and efficient competence-allocation. As the Convention has not considered these issues sufficiently in its draft Constitutional Treaty, the Intergovernmental Conference should take courage and rethink seriously the stated pre-requisites of efficient and flexible competence allocation.

Notes

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2. Tel.: +43-1-31336-4138, fax: +43-1-31336-758.
3. See <http://european-convention.eu.int/docs/sessplen/00369.en2.pdf>.
4. See <http://european-convention.eu.int/ArticlesTraites.asp?lang=EN>.
5. See http://european-convention.eu.int/doc_wg.asp?lang=EN&Content.
6. See <http://european-convention.eu.int/docs/Treaty/cv00850.en03.pdf>.
7. Inspired by the EU Convention, the Austrian government has also launched an “Austrian Convention” to overhaul the Austrian Constitution (see <http://www.konvent.gv.at/>). This should also deal with Austrian federalism (Bund – Länder relationship) and rethink the adequate assignment of competencies to the different federalist levels.
8. In practice we can find examples of this governance type in Switzerland: “Zweckverbände” (goal-oriented/functional associations) at the local level.
9. Accordance of cost and benefit units; the “Principle of Fiscal Equivalence” has originally been developed by Olson (1969) – more details can be found in Thomas (1997) or Zimmermann and Henke (2001).
10. See <http://europa.eu.int/celex>.
11. Besides the GFS, following OECD sources are used for empirical decentralisation analysis: National Accounts, Revenue Statistics, Fiscal Design Surveys Across Levels of Government.
12. An additional evaluation of applicability of GFS as a data set for measuring FD is provided by Ebel and Yilmaz 2002: 6f.
13. The expenditure categories are adopted from the Government Finance Statistics Yearbook 2001 of the IMF.
14. See <http://www1.worldbank.org/publicsector/decentralization>.
15. The endorsement by qualitative indicators is discussed on the World Bank’s Web site on FD, see <http://www1.worldbank.org/publicsector/decentralization/qualitativeindicators.htm>.
16. “If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal of the Commission and after consulting the European Parliament, take the appropriate measures.”
17. Mueller refers to four further safeguards which are necessary to maintain a federalist structure: (a) lower level geographic interests should not be represented at each level of government, (b) specific governmental functions should be assigned in the constitution to each level of government (remark: this recommendation is contrary to our aforementioned prerequisite of reversibility – see the dis-

discussion regarding competence catalogues), (c) the constitution should contain general principles for assigning new issues (see the discussion regarding the revision procedure) and (d) decisions should be made via direct democracy (in particular referendum, considering Switzerland as an example).

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