

I. What Are Federal Governments?

- A. To this point in the course, we have examined how governmental decision making can be organized in a single--essentially unified government. That is to say, what ever the government of interest "says" is what becomes public policy.
- i. We have talked about relationships among individual who participate in the governmental decision making process: voters, members of parliament, presidents and kings rather than relationships between governments.
 - ii. However, relationships between governments can be important both among countries, as with international treaties and *within* countries as with federal and other decentralized systems of governance.
- B. A federal system of government has many independent governments within its national boundaries.
- i. Generally, there is one national governments, a series of regional (state, provincial, lander etc.) governments, and a series of sub regional governments within each region (town, village, county, city, etc.).
 - ii. Political scientists insist that federal governments also be bicameral with one chamber representing regional governments and have a long history of regioal autonomy, but his is totally unnecessary from a behavioral point of view.
 - iii. What effects the behavior of federal system is the degree to which the individual governments are selected independently and have policy areas in which they are free to make decisions.
- C. That is to say, what matters is the degree to which policy making authority is decentralized.
- i. Here we may note that a federal government like Spain, which provides only very limited autonomy to its regional and local governments and has a regional chamber, is in many respects "less federal" than Sweden where local governments have very significant areas of autonomy.
 - ii. The interesting properties of federal system arise because of the ability of subnational governments to make policies in a setting where local governments are truly local in the sense that they are selected locally, for example by local voters in a democratic polity.
 - a. Local autonomy means that policies may vary from region to region according to the preferences of local government officials.

- b. Local selection implies that local interests are advanced by local autonomy insofar as local official are selected by (elected by) and thus accountable to local voters (interests).
- D. Local autonomy does not have to be complete or extensive in a federal system. However, the greater is local autonomy, the more decentralized a federal system may be said to be.
- i. As local autonomy increases from very little toward intermediate levels, bargaining between levels of governments become increasingly important in settling policy matters.
 - ii. As local autonomy increases beyond moderate levels, local governments become increasingly free to neglect the "national" interests when setting policies.
 - iii. The range of decentralization, thus, varies from none (a completely centralized unitary state) to complete autonomy (a completely decentralized confederal state or alliance).
 - iv. Most modern nation states fall in the middle range, where local governments possess considerable, but not complete autonomy.
- E. In most cases, federal governments, the national government has dominant authority, in the sense that it can make rules that bind regional and local governments, but local governments control a variety of local public services.
- i. Examples of public services provided locally: include public education, police, fire protection, local highway construction, land use policies, mass transit.
 - ii. Local governments often have greater control over expenditures and local regulations than they have over local tax revenues, but many federal governments "provide" local governments with considerable tax authority.
 - a. For example, in Sweden local governments control the income tax, while the central government sets property and VAT taxes.
 - b. In the US state governments use sales and income taxes, while local governments rely mostly on property taxes.

II. The Case for Decentralized Federalism: Federalism as a Method for Advancing Super Majority Interests

- A. The decentralized method of using majoritarian politics, which will be referred to as federalism or fiscal federalism, has the interesting feature that it tends to

generate a pattern of government service levels that secures greater than majority support.

- B. To see this, consider a constitution that called for local and national parliaments to be elected as above and specified areas of policy that would be entirely determined by the local parliaments.
- i. Such a “federal” system has several advantages over a unitary state.
 - ii. One advantage is that local electorates tend to be better informed about the effectiveness of local government programs and politicians than national ones, because they have more *direct experience* with both local programs and local administrators.
 - iii. Consequently, less research needs to be carried out by voters and results in local elections tend to be based on somewhat better voter information than those of national elections.
- C. Other advantages of fiscal federalism over unitary governance follow from the fact that the cost of moving between local jurisdictions is generally lower than that of moving between national jurisdictions.
- i. Distances are smaller in both spatial and cultural terms. Consequently, voters tend to have a broader direct experience with alternative policies, which increases incentives to innovate and copy methods from relatively more effective rivals.
 - ii. Mobility also makes it easier for a minority to avoid bad outcomes from local governments than national governments.
 - iii. Moreover, mobility induces a bit of competition among local governments for residents and other mobile parts of the tax base. Mobility implies that “best practices” tend to become better through time.
- D. Local electorates tend to be more homogeneous than national electorates for several reasons, including mobility among localities, differences in regional climate and geology, and shared history.
- i. The greater homogeneity of local demands for public services, regardless of origin, implies that more persons can get more nearly the exact balance

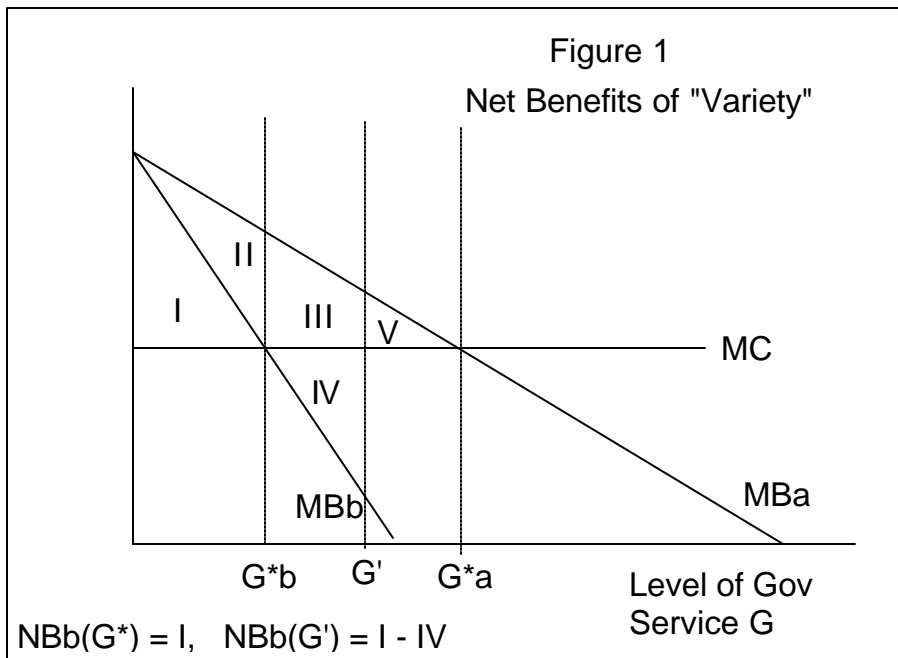
of services in areas of local authority than is possible with uniform national provision of the same services.

- a. This feature of decentralized democracy tends to generate broad benefits for the electorate as a whole, including national minorities.
 - b. A supermajority of the national electorate will prefer the pattern that emerges from decentralized policy making to any uniform level provided by the national government.¹
- E. It also bears noting that local governments will find it more difficult to advance the interest of narrow special interest groups whose interests conflict with general local interest.
- a. Preferential policies are generally more difficult to hide at the local level, and mobility allows those disadvantaged by such policies to seek better treatment elsewhere.
 - i. Moreover, the homogeneous makeup of smaller communities tends to provide fewer opportunities for preferential treatment (everyone cannot be treated better than everyone else).
- F. Overall, these properties of fiscal federalism suggest that, in at least some policy areas, the interests of both “national minorities” and “national majorities” can be simultaneously advanced.²
- i. Variation in service levels among communities, together with mobility and relatively lower information costs of policy information, encourage a better alignment of interests between the government and the population that is directly served at little or no cost.
 - ii. Federalism (or fiscal federalism), thus, provides a possible method of advancing the broad interests of the national electorate.
- G. In such policy areas, *decentralization encourages a broader menu of services, which more perfectly serves the persons living in the communities served than any uniform national level of*

¹ This is implied by W. Oates’ (1972, ch. 2) proof of the decentralization theorem. His small book still provides one of the best overviews of the merits of federal systems of governance from an economic perspective.

² Of course, not all government programs can be accomplished by local governments. Oates (1972) notes that broad macroeconomic policies and efforts to equalize incomes or opportunities for citizens within the nation as a whole cannot be easily done at a local level. Such truly nationwide policies would properly be decided by the central government. Any broad interest in equalizing incomes or opportunities across communities may be advanced with a system of equalizing block grants.

service can. (This is the "economic" case for the **subsidiarity principle**.)



III. Is the EU a Federal System?

A. The European Parliament and the Council of member states closely resembles the structure of modern federal democracies in which the "legislature" consists of a directly elected chamber and an indirectly elected federal council.

- i. The *Consolidated Version of the Treaty Establishing the European Community* describes the architecture of the government of the EU. Articles 189-191 state that the representative European Parliament "shall be elected by direct universal suffrage."

- ii. Articles 202-203 state that the Council "shall consist of a representative of each Member State at ministerial level, authorized to commit the government of that Member State."
- iii. The legislative procedures specified in the EU's present constitution are complex, but it is clear that in many, perhaps most, policy areas both the Council and the Parliament have to agree about the policies adopted, although the balance of power currently favors the Council over the Parliament.³

B. The commission can be regarded as the cabinet or "the government" for the present purposes.

- i. The Commission clearly has significant autonomy, after its appointment, as is also true of the cabinets of many parliamentary systems, but ultimately it remains controlled by the Council and the member states.
- ii. Its membership is selected jointly by the nations represented in the Council with consultation by the European Parliament (Article 214).
- iii. The Council can determine the size of the Commission (Article 213) and commission salaries (Article 210).

C. The representation of European nations established in both the Council and the Parliament can be regarded as somewhat nondemocratic because some voter's interests are given greater weight than others.

- i. For example, Germany is arguably being underrepresented and Luxembourg substantially over represented.
- ii. This tends to be the case within all region-based forms of allocating representation insofar as the number of representatives (or votes by them) are constrained to be whole numbers.

D. Overall, however, it is clear that the regional governments (nation states) have considerable autonomy, and have the right to leave the EU if they wish.

³ Article 252 of the *Consolidated Version of the Treaty Establishing the European Community* states that: "Where reference in this Treaty to this Article for the adoption of an act, the following procedure shall apply: (a) The Council, acting by qualified majority on a proposal from the Commission and after obtaining the opinion of the European Parliament, shall adopt a common position. (b) The Council's common position shall be communicated to the European Parliament. The Council and the Commission shall inform the European Parliament fully of the reasons which lead the Council to adopt its common position and also of the Commission's position. ... (c) The European Parliament may within the period of three months by an absolute majority of its component Members, propose Amendments to the Council's common position. The European Parliament may also by the same majority reject the Council's common position. ...If the European Parliament has rejected the Council's common position, unanimity shall be required for the Council to act on a second reading."

The commission may subsequently submit a revised proposal, which the council alone may consider. Amendments of this proposal by the Commission require unanimous agreement by the Council. (A. 252[e]).

- i. (This right is implicit in national sovereignty, but will become explicit if the new treaty/constitution is adopted.)
- ii. Indeed, the level of autonomy is so large, that the EU might better be considered a treaty organization or a form of "confederation" rather than federation.
- iii. On the other hand, the extensive rule making power of the EU government as a whole clearly restricts the rule making authority of the member governments in a manner that is very similar to that which a national government exercises over its regional governments.
- iv. In this sense the EU can be regarded as a federal government in practice, even if its constitution is a bit ambiguous about its "political form."

IV. Empirical Perspectives on Fiscal Federalism

- A. There is a good deal of empirical work that suggests that more decentralized federal system on average provide public services more efficiently and at lower cost than more centralized systems.
 - i. See, for example, Elazar, D. J. Ed. (1991) *Federal Systems of the World: A Handbook of Federal, Confederal, and Autonomy Arrangements*. Essex: Longman Group Limited. Inman, R. P. and Rubinfeld, D. L. (1997) "Rethinking Federalism," *Journal of Economic Perspectives* 11: 43-64. Oates, W. E. (1972) *Fiscal Federalism*. New York: Harcourt, Brace, Jovanovich.
 - ii. See Frey, Bruno and Eichenberger, Reiner (1996) "FOJC. Competitive Governments for Europe," *International Review of Law and Economics* 16:315-327. for an interesting extension of the logic of fiscal federalism.
 - iii. See also Mueller, D. C. (2006, forthcoming) "Federalism, A Constitutional Perspective," in Congleton and Swedenborg, *Constitutional Design and Public Policy, Analysis and Evidence*. Cambridge:MIT Press.