

# Chapter 3

# Decision making

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## Introduction

A great debate has been raging in Europe for years: What is the appropriate division of powers between the EU and its member nations? As the historical discussion in Chapter 1 recounted, this tension between pooling sovereignty at the EU level to foster cooperation, and keeping it at the national level to keep power close to the people, has been a constant issue since the late 1940s.

In the 1960s, French President Charles de Gaulle boycotted EU meetings and threatened to take France out of the EU over similar issues when he thought France was losing too much sovereignty. In the 1990s, the notion of 'subsidiarity' arose to address German *Länder* concerns that their powers – granted to them by the German constitution – were being taken away from them by EU treaties. The tension exists since the EU started its life with centralization as a key goal – perhaps the primary goal – of the nascent EU. The opening sentence of its founding document – the 1958 Treaty of Rome – declares that the European Union is 'Determined to lay the foundations of an ever-closer union among the peoples of Europe.' Note that the sentence does not mention European nations, only European peoples. But after six decades and a massive increase in the pooling of sovereignty, the appetite for more centralization is greatly diminished.

Enthusiasm for deeper integration has notably cooled. When EU law was massively revised by the 2009 Lisbon Treaty, the famous phrase 'ever closer union' was demoted to the thirteenth paragraph. Moreover it was diluted and qualified with a caution on centralization. The phrase is now completed with 'in which decisions are taken as closely as possible to the citizen in accordance with the principle of subsidiarity'.<sup>1</sup> Reflecting such concerns, Lisbon created a formal role for Member State Parliaments in policing subsidiarity. This takes the form of an 'early warning mechanism' whereby a third of national parliaments can issue a 'yellow card' against a proposed EU law on the grounds that it violates the principle of subsidiarity.

This chapter presents frameworks that should help the reader think at a more abstract and analytical level about this great debate. It should also help readers understand affairs in their own nations since the same problem exists within nations, say between the national, provincial and local levels. The chapter is organized around two major questions:

- 1 Who should be in charge of what? That is, which decisions should be taken at the EU level and which should be taken at the national or subnational levels?
- 2 Is the EU-level decision-making procedure efficient and legitimate?

In answering these questions we shall examine the EU's actual practice and develop a number of specific analytical tools. Moreover, we shall look at proposed reforms of the system in response to recent and future enlargements that challenge the EU's decision-making structure.

### 3.1 Task allocation and subsidiarity: EU practice and principles

Governments set policies in many areas – speed limits on roads, school curriculums, monetary policy, taxation, import taxes on Chinese T-shirts, development of nuclear weapons, deployment of troops abroad, and so on. Plainly, not all of these policies are made by the same level of government. Most European nations have at least three levels of government (local, provincial and national) and EU members have a fourth level of government, the EU.

Although European nations differ in their attitude towards internal centralization (e.g. France tends to centralize many more issues than does Belgium), there is usually a fairly clear allocation of tasks to the four levels of government in each nation. Typically, local speed limits are set by the local government, but motorway speed limits are determined at the national level. Anything to do with military matters is dealt with at the national level, but local nature reserves are likely to be addressed at the provincial level.

In short, there seems to be a 'method to the madness' – some systematic thinking. But what is the logic behind this allocation of tasks? This is the main question we turn to now. We begin by covering the existing EU principles that guide the allocation of policies between the EU and Member States and

<sup>1</sup> Readers can find the Treaties conveniently collected at [http://europa.eu/about-eu/basic-information/decision-making/treaties/index\\_en.htm](http://europa.eu/about-eu/basic-information/decision-making/treaties/index_en.htm).

briefly cover their practice. The next section presents an analytic framework for organizing thinking about the appropriate allocation of tasks among the various levels of government.

### 3.1.1 Introduction to 'competences'

In EU jargon, this task allocation is called the question of 'competences'. Areas in which the EU alone decides are known as 'exclusive competences' or 'Union competences'. Those areas in which responsibility is shared between the EU and Member States are called 'shared competences'. There are two types of shared competence: those whereby members cannot pass legislation in areas where the EU has already done so and those whereby the existence of EU legislation does not hinder members' rights to make policy in the same area (see Table 3.1, for examples). The third type is a 'supporting, coordinating or complementary competence' whereby the EU can pass laws that support action by members. The most common names are 'supporting competence' and 'supporting action'. Finally, tasks whereby national or subnational governments alone decide are called 'national competences'.

**Table 3.1** Allocation of competences to the EU

Exclusive	Shared		Support, coordinate or supplement
	Exclusive if EU has policy	Non-exclusive	
Customs union	Exclusive if EU has policy	Non-exclusive	Certain human health policies
Competition policy	Internal market	R&D policies	Industry
Eurozone monetary policy	Certain social policy	Outer space policies	Culture
Conservation of marine resources	Cohesion policy	Development cooperation	Tourism
Common commercial policy	Agriculture and fisheries	Humanitarian aid	Education and training
	Environment		Civil protection and disaster prevention
	Consumer protection		Administrative cooperation
	Transport		Coordination of economic, employment and social policies
	Energy		Common foreign, security and defence policies
	Old third pillar 'Area of freedom, security and justice'		
	Certain public health policies		

Source: Treaty on the Functioning of the European Union.

Some tasks and decisions are clearly assigned to the EU, such as competition policy whereby the EU has the final say on, for example, mergers that affect the European market. Others are clearly assigned to Member States, such as the secondary school curriculum. A great number, however, are shared between the EU and Member States. As is true of so many things in the EU, the exact dividing lines are unclear. The Lisbon Treaty substantially improved clarity on this point, but much is still open to interpretation.

The basic source of ambiguity is that areas of exclusive Union competence are defined partly by reference to functional descriptions. For example, the Union has exclusive competence when it comes to international agreements when it is 'necessary to enable the Union to exercise its internal competence, or insofar as its conclusion may affect common rules or alter their scope'. Plainly, the meaning of 'necessary' would be open to interpretation in many cases. The Treaties' objectives are ambitious, so this proviso puts a great many tasks in the grey area between Community competence and national competence. Often, the dividing line has been established by the European Court.

Task allocation is further blurred by the so-called flexibility clause, which allows the EU to obtain additional competences when necessary; however, this requires an elaborate procedure (see the 'Flexibility clause' section below).

### 3.1.2 Principle governing the allocation of competences

The touchstone principle is that the EU has no powers intrinsically. Article 1 of the Treaty on European Union says that it is the members that confer competences on the EU in order to attain objectives they have in common. This is the 'principle of conferral', that is, the default option is that competences remain with the members.

While the limits of EU competences are governed by the principle of conferral, the use of these is governed by the principles of 'subsidiarity' and 'proportionality'. Both words have distinct meanings in the EU.

#### *Subsidiarity and proportionality*

The principle of subsidiarity pursues two contrasting goals: (1) to allow the EU to act if a problem cannot be adequately addressed by national policies alone, and (2) to guard national sovereignty in those areas that cannot be dealt with more effectively at the EU level. The overarching goal is thus to keep decisions as close to the citizen as possible without jeopardizing win-win cooperation at the EU level. As Borchardt (2010) puts it, 'when it is not necessary for the EU to take action, it is necessary that it should take none'.

The principle of proportionality comes into play when EU action is necessary, that is, when the objectives of the Treaties can be better achieved at the EU level or in an area in which the EU has exclusive competence. In such situations, the proportionality principle says that the EU should undertake only the minimum necessary actions.

Here is an example of how the subsidiarity and proportionality principles work. The uncoordinated setting of VAT rates would hinder the smooth functioning of the internal market by, for example, leading to massive cross-border shopping driven by VAT differences. The principle of subsidiarity thus suggests that coordinating action at the EU level would be better than uncoordinated action at the national level. In short, the EU should do something to harmonize VAT rates. The principle of proportionality, however, suggests that all that is needed is *some* harmonization, *not complete* harmonization. In keeping with the principle of proportionality, the EU agreed to minimum and maximum VAT rates but let members decide their own rates within the band.

Practically, these principles mean that the 'burden of proof' lies on the instigators of EU legislation. They must make the case that there is a real need for common rules and common action in the area and that the proposed rules or actions restrict national sovereignty as little as possible.

#### *Flexibility clause*

The conferral principle says that the EU can act only in areas in which Member States have conferred power to it in the Treaties; however, there are situations when a new challenge – one not foreseen in the Treaties – arises that requires action at the EU level. One way to deal with this would be to require a Treaty modification each time such things arose. As Chapter 1 showed plainly, changing treaties can be a long and tricky process.

### 3.1.3 Competences in practice

The Treaties as amended by the Lisbon Treaty spell out the EU's competences more clearly and more explicitly than was the case before. Indeed, this is one of its major accomplishments. Table 3.1 lists the areas in which the EU has competences. All other areas are exclusive competences of the members since any power not explicitly conferred upon the EU remains with the members.

The biggest switch, as noted in Chapter 2, is that of Home and Justice Affairs from intergovernmental treatment (i.e. whereby the EU had no competences at all) to shared competence. This is a natural follow-on from decades of tight economic integration. Europeans are just more tied up with one another, and so many face cross-border legal issues that rarely arose in the last century – things like marriage contracts, retirement plans and house buying.

The third category – support, coordinate or supplement – is new and very useful as the Commission has increasingly turned to this sort of 'soft law' approach in the face of resistance to more direct policies. For example, when it comes to competitiveness, it provides frameworks and benchmarking structures that help members coordinate without actually requiring them to do anything specifically. By putting this category of action into the Treaties, the legal status of such actions was clarified.

## 3.2 Understanding the task allocation: the theory of fiscal federalism

The last section considered EU principles and practices, but it did not explain the logic underpinning them. This section uses economic reasoning to help readers understand the allocation of tasks in a systematic way. Of course, as the old saying goes: 'The difference between theory and practice is greater in practice than it is in theory', but most readers will find it easier to remember the practice if they understand the underpinning logic.

This section presents a framework for thinking about the most appropriate level of government for each type of task. A complete consideration of this question, however, would take us into subjects (political science, sociology, national identity, etc.) that are too far afield for this book. The main line of thinking presented here is called the theory of 'fiscal federalism'. Even though this provides only an incomplete approach to the question, it proves to be a very useful framework for organizing one's thinking about the basic trade-offs.

### 3.2.1 The basic trade-offs

We focus on five important considerations when thinking about the appropriate allocation of policy-making tasks to the various levels of government. In the real world, the five blend together in complex ways. To clarify our thinking, however, we consider each in isolation. The first concerns local diversity.

#### *Diversity and local informational advantages*

When people have very different preferences, centralized decision making creates inefficiencies. There are both obvious and subtle aspects to this point.

The obvious aspect is that a single, centrally chosen policy will typically be a compromise. By definition, a compromise will not be the right policy for everybody. Take the example of road speed limits. Suppose the German federal government could choose only one speed limit for the whole country. The result would be a limit that was too slow for the autobahn but too fast for residential neighbourhoods. (Of course, for some policies, choosing one policy for the whole nation might reduce costs but we put that aside for clarity's sake and deal with it below under 'Scale economies'.)

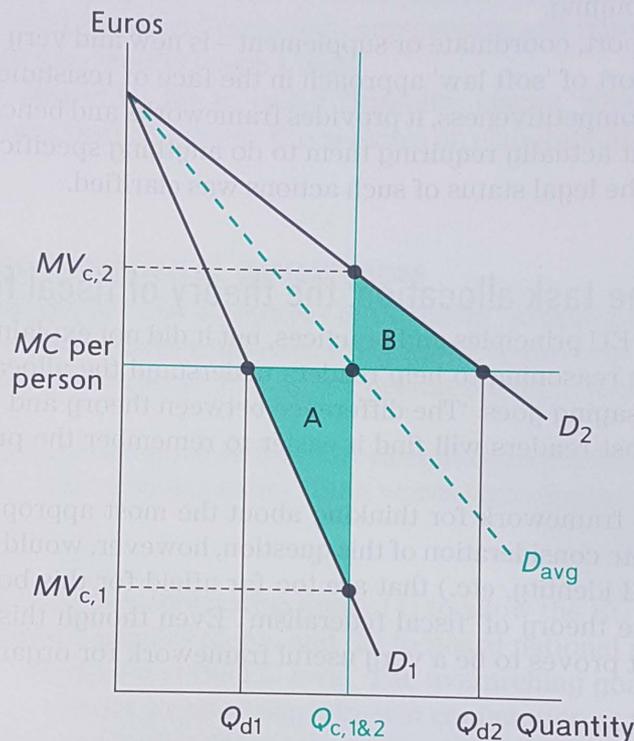
The subtle aspect concerns local information about diverse situations and preferences. The speed limit example seemed strained since the federal government could set different speed limits for different roads. The subtle point is that, if many different limits are to be set, local governments are probably better at determining which limit to apply to which roads in their localities. This is basically an issue of the cost of acquiring the information necessary to adapt policies to local conditions and preferences. As a general principle (to which there are many exceptions), local governments can acquire such information more cheaply and so the decision-making task should be allocated to the local level.

The general idea is more concretely illustrated in Box 3.1.

### Box 3.1 Economic inefficiency of a one-size-fits-all policy

To illustrate this general idea more concretely, we turn to Figure 3.1. (The figure employs supply and demand analysis and the notion of consumer surplus; see Chapter 4 if you are unfamiliar with this type of reasoning.)

**Figure 3.1** Diversity of preferences and decentralization



*Note:* The diagram assumes that individuals in each region are identical and the governments are 'benevolent'.

*Technical note:* The  $MC$  per person =  $MV$  criterion is identical to Samuelson's famous sum of  $MV$  condition since  $MC/N = MV$  implies  $MC = N * MV$ , where  $N$  is the number of people in the region.

The figure shows demand curves for a particular public service. One is for an individual located in region 1 (marked as  $D_1$ ) and the other for a person in region 2 (marked as  $D_2$ ). We assume that, for some reason, people in the two regions have different preferences for public services. For example, if we are talking about the density of public bus services, people in region 2 might live in a city where commuting by car is difficult, so they prize bus services more highly than do the people in region 1. These relative preferences can be seen from the fact that  $D_1$  is below  $D_2$ ; from the consumer surplus analysis in Chapter 4, this means that the marginal value of a slight increase in the density of bus services is lower for individuals in region 1 than it is in region 2.

To start the analysis, we work out the level of bus services that would be provided if the levels were chosen separately by the region 1 and region 2 governments. The region 1 government would best serve its citizens by choosing the level whereby a typical region 1 person's marginal value of a denser bus service (i.e. more buses per day and/or more routes) was just equal to the per-person cost of providing the extra service. In the panel, this optimal level is  $Q_{d1}$  for region 1 (the  $d$  stands for decentralized and the  $1$  for region 1). Region 2's government would choose a higher level, namely,  $Q_{d2}$ . (This assumes, for simplicity, that the marginal cost is constant at all levels of service and identical across regions.)

Contrast this with the situation whereby the policy decision is centralized so that the same level is chosen for both regions. In this case, the central government would look at the average preference for bus services as reflected by the average demand curve marked as  $D_{avg}$ . Using the same reasoning as with local governments, the optimal average provision is shown by  $Q_{c, 1\&2}$ .

How do these two situations compare in terms of people's welfare? Taking the decentralized choice as the initial situation, the figure shows that people in both regions are made worse off by centralizing the decision. The people in region 1 are forced to pay (via their taxes) for a level of bus service that is too high for their preferences. The loss to a typical region 1 person is given by the triangle 'A' since this measures – for each extra increase in  $Q$  – the gap between the marginal value of the denser service and the marginal cost. The marginal value is given by the demand curve  $D_1$  and the marginal cost is given by the *MC per person* line. Region 2 residents also lose, but for them the loss stems from the fact that they would like a denser service than is provided when decision making is centralized. In particular, area B shows their losses since it measures, for each unit reduction of  $Q$ , the gap between their marginal value (given by  $D_2$ ) and the marginal cost (given by *MC per person*).

In summary, the diagram shows the rather straightforward point that choosing a one-size-fits-all policy leads to an inferior outcome when people have diverse preferences. If the  $Q_s$  are chosen separately for the two regions, there is no reason to centralize the decision. It will typically be cheaper for local authorities to determine what is optimal for their region. More specifically, suppose it costs  $X$  euros more for the central authorities to get the information than it would cost local authorities. Since the decision would be the same in both cases ( $Q_{d1}$  and  $Q_{d2}$  are chosen), the centralized decision making is worse since taxpayers will have to pay the extra information-gathering cost,  $X$ .

### Scale economies

The advantage of localized decision making in terms of information efficiency is really quite a robust result. Yet in many situations there are offsetting cost savings from a one-size-fits-all policy that arise from scale economies, that is, the notion that the per-person cost of a service falls as more people use the service.

For example, in the case of bus services, it seems reasonable to believe that the cost per kilometre of bus service tends to fall as the number of buses gets larger. A large bus company can more easily ensure that the right number of drivers is available, the fixed cost of a maintenance centre can be spread over more buses, and the per-bus cost of administration may fall – at least up to a point – when the bus company is larger. Imagine an extreme situation where every bus in, say, Paris was owned and operated by separate companies versus the situation where all the buses were owned by a single company. Surely the latter would be more efficient in terms of costs.

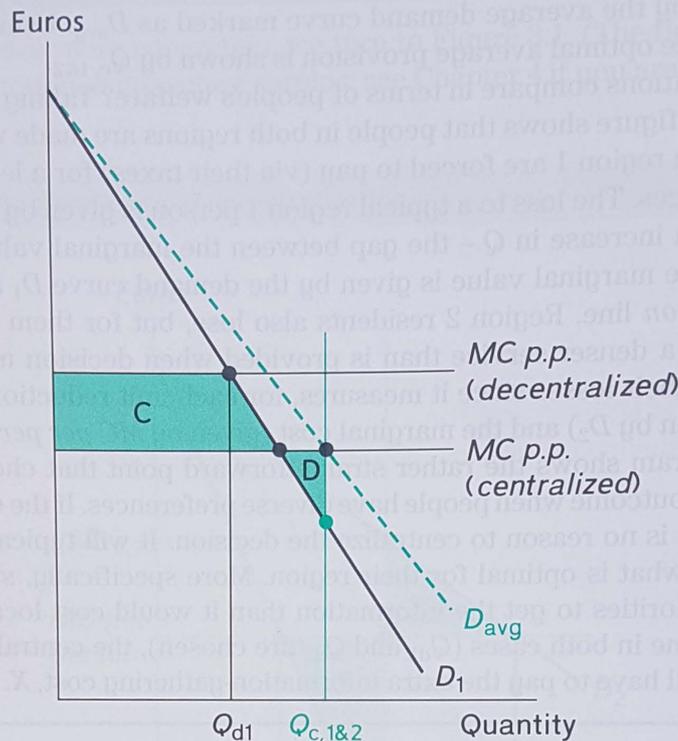
To sum up, economies arising from joint decision making tend to favour centralization, while diversity of preferences and local information advantages favour decentralization. We turn next to another key issue that arises when the decisions made in one region affect people in other regions. In economics jargon, these are called 'spillovers'.

To understand the economics of the scale versus diversity trade-off, see Box 3.2.

### Box 3.2 Economic gains from scale versus losses from one-size-fits-all

The widespread presence of scale economies in the provision of public services – transport services, medical services, etc. – tends to favour centralization. To see this point, we refer to Figure 3.2. The diagram focuses only on the impact of centralization on the typical region 1 individual. In the decentralized situation the marginal cost per person of a denser bus service is shown by the line marked *MC p.p. (decentralized)*. In the case of centralized services, the marginal cost is lower, namely, *MC p.p. (centralized)* due to scale economies.

Figure 3.2 Scale economies and centralization



The figure shows that there is a trade-off between having the level of service precisely adjusted to local preferences and having a lower service cost due to scale economies. When the decision is local, the optimal provision is – as in Figure 3.1 –  $Q_{d1}$ . When it is centralized, the marginal cost is lower so the intersection of marginal value of the average citizen ( $D_{avg}$ ) and marginal cost is at  $Q_{c,1\&2}$ . As before, the level that is optimal for the average citizen is not right for region 1 people, so there is inefficiency; again, this is measured by a triangle, marked  $D$  in Figure 3.2. This inefficiency, however, is offset by the gain from scale economies. That is, the region 1 person faces a lower marginal cost; the benefit of this is shown by the four-sided area,  $C$ . (The gain is just like a price reduction in standard consumer surplus analysis; see Chapter 4 for details.)

It appears, from the figure, that the gain from scale economies outweighs the loss from one-size-fits-all decision making. But, of course, if the scale economies were less important (i.e. the  $MC$  fell by less) or preferences were more diverse (i.e. the  $D_{avg}$  curve was further from the  $D_1$  curve), then decentralization would be the superior outcome. The analysis for region 2 is quite similar and so it is omitted for the sake of brevity.

### Spillovers

The next major consideration guiding task allocation is ‘spillovers’, that is, an economic side-effect, known in economics jargon as an ‘externality’.

Many public policy choices involve multi-region effects. National defence is one extreme. The presence of an army almost anywhere in the country deters foreign invasion for the country as a whole, so all the nation’s citizens benefit from the army. It would be silly in this case to have taxpayers in each city decide separately on the army’s size since, in making their decision, each set of taxpayers is likely to undervalue the nationwide benefit of a slightly bigger army. This is why the size of the army is a decision that is made at the national level in almost every nation. This is an example of what are called ‘positive spillovers’, that is, where a slightly higher level of a particular policy or public service in one region benefits citizens in other regions.

A similar line of reasoning works when there are negative spillovers – when one region's policy has a negative effect on other regions. A good example of this is found in taxation. The value added tax (VAT) rate is set at the national level in all EU nations, so consider why this is so. If the VAT were chosen by each region, regions might be tempted to lower their VAT rate in an attempt to lure shoppers. For example, if the VAT in the centre of Frankfurt were 25 per cent, one of its suburbs might set its VAT at, say, 15 per cent in order to draw shoppers to its shops. In fact, if this tax undercutting were effective enough, the suburb would actually see its tax collection rise. (If the rate reduction was more than matched by an increase in local sales, the total VAT collected by the suburb would increase.) Of course, if the suburb's tax-cutting worked, Frankfurt would probably have to respond by lowering its rate to 15 per cent. In the end, both Frankfurt and the suburb would charge VAT rates below what they would like, but neither would gain shoppers by doing so. This negative spillover is so famous that it has a name: 'race to the bottom'. Again, the solution that is adopted by most nations is to set the VAT rate at the national level, but this time it is done to avoid negative spillovers.

As it turns out, cross-border shopping is not much of a problem in most parts of the EU, so there is little incentive to completely harmonize VAT rates at the EU level. The EU does, however, require VAT rates to fall within a wide band so that the maximum difference between VAT rates cannot be massive.

In summary, the existence of important negative or positive spillovers suggests that decisions made locally may be suboptimal for the nation (or EU) as a whole. The very existence of spillovers, however, does not force centralization. First, it may be possible to take account of the spillovers via cooperation among lower-level governments. This does not work for all policies, however, since cooperation is very difficult to sustain when the policies are difficult to observe directly and the spillovers are difficult to quantify. Moreover, even if decentralized cooperation does not work well, one may still resist centralization when there are big differences in preferences. A very interesting case study in this sort of fiscal federalism trade-off concerns the EU's different treatment of general VAT and extra sales taxes, or excise taxes on alcohol and tobacco. National preferences within the EU vary enormously when it comes to alcohol and tobacco, so although there is at least as much an argument for partly harmonizing these taxes as there is for harmonizing general VAT rates, the EU has never been able to do so. See Box 3.3 for details.

### Box 3.3 Beer, cigarettes and VAT harmonization

Since 1 January 1993, EU travellers have been allowed to buy unlimited quantities of alcohol and tobacco (for their own use) in any Member State, and, as long as they pay taxes due in the Member State where they bought the goods, no additional taxes are due when they return home. This has posed some problems for British fiscal authorities since Britain has some of the highest 'sin' taxes in Europe.

While there has been some progress towards the harmonization of excise duties across the EU (incorporated into EC directives adopted on 19 October 1992), this effort consists of establishing specific minimum rates that are quite low. As House of Commons (2002) notes: 'The sheer variation in duty rates between countries made any closer form of harmonisation politically infeasible.' For example, in the UK beer duty is 34p per pint (5p in France, 3p in Germany and 7p in the Netherlands), duty on a 75 cl bottle of spirits is £5.48 (£2.51 in France and £1.19 in Spain), and the total excise duty on a packet of 20 cigarettes is £2.80 in the UK (£1.22 in France, £1.00 in the Netherlands and 99p in Belgium).

Such differences could, of course, lead to massive tax fraud, if, for example, all British publicans stocked up in France, claiming that their truck load of beer was for personal use. To prevent this, Britain set indicative levels for how much alcohol and tobacco constitutes 'for personal use'. These levels are rather generous: 10 litres of spirits, 20 litres of fortified wines, 90 litres of wine, 110 litres of beer, 200 cigars, 400 cigarillos, 800 cigarettes and 1 kg of smoking tobacco. The problem became so severe that the UK began to seize the vehicles used in this sort of fiscal smuggling – taking over 10,000 vehicles in 2000–01.

The Commission felt this was too harsh and referred Britain to the European Court. As Frits Bolkestein, European Commissioner for taxation and customs union at the time, said: 'I understand any member state's need to fight fraud but the Commission simply cannot accept penalties that are so disproportionate that they interfere with the rights given to EU consumers by the EU single market to go shopping in other Member States' (2004). In 2006, the dispute was settled out of court. The UK modified its seizure policy and clarified its laws. For example, first-time offenders can choose between forfeiting the goods and paying a penalty.

Source: Based on House of Commons (2002) and [www.cec.org.uk](http://www.cec.org.uk).

### Democracy as a control mechanism

The analysis up to this point has assumed that governments are interested only in the well-being of their citizens. The next major consideration in task assignment takes a more cynical view of governments' motives.

There are perfect public servants in this world, but not all government officials and politicians are totally selfless. For example, it is quite common for politicians to systematically favour politically powerful special-interest groups – for example, granting them tax breaks, subsidies and favourable laws – even when this is bad for the average citizen.

Because of this divergence of interests between voters and decision makers, all European nations have adopted arrangements that check the power of politicians and force governments to stay close to the interests of the people. Democracy is the most powerful of these mechanisms.

Since politicians must win the approval of the citizens on a regular basis, they are reluctant to misuse their decision-making power. From this perspective, democracy can be thought of as a control mechanism. The importance of this observation is that it helps to inform the allocation of policymaking among levels of government. To understand this, however, we need to think more carefully about how elections discipline politicians.

Although democratic procedures vary across European nations, the following is a stylized version that fits many instances. When a politician runs in an election, the politician or his or her party presents a package of promises to the voters. The voters choose between packages and hope that the winner will actually do what he or she promised (deviations without good reason can be punished in the next election). The fact that issues are packaged together and that voters face a limited range of packages gives politicians some leeway. That is to say, their package does not have to fully represent the best interest of the voters; it only has to be good enough to get elected. This means that parties and politicians have room to slip in policies that favour small but influential special-interest groups. Because special-interest groups tend to provide money and other support in election campaigns, skewing the package in favour of these groups tends to increase the likelihood of winning an election.

Given this logic, voters' control over their elected decision makers depends upon the breadth of the package of promises. If democracy consists only of electing national officials once every four or five years, the package of promises must include a vast range of things. This gives politicians and parties a great deal of room to undertake policies that are not in the interest of the general public. By contrast, if the election is for a town mayor, the package will be quite specific and this tends to reduce the room for special-interest politics.

This logic is important. It underpins the basic presumption that decisions should be made at the lowest practical level of government. Or, to put it differently, decisions should be made as close to the voters as possible. As mentioned in the previous chapter, the EU's 'subsidiarity principle' does just this.

### Jurisdictional competition

The final element to consider also favours decentralized decision making. It is called 'jurisdictional competition'. Voters can influence the sort of government they live under in two main ways, 'voice' and 'exit'. Voice is what we have just discussed – the ability to control politicians and parties by speaking up, in particular by voicing one's opinion at the ballot box. The other way is to leave the jurisdiction that imposed the policy. This is exit.

While exit is not an option for most voters at the national level, it usually is at the subnational level. For example, if someone strongly objects to a lack of, say, parks and green areas in a particular town, they could move to a different town. This is called jurisdictional competition since the fact that people can move forces decision makers to pay closer attention to the wishes of the people. By contrast, if all decisions are centralized, voters do not have the exit option. This reduces the pressure on local governments to be efficient in the provision of public services. To put this differently, even if voters rarely move, the fact that they could move if things got bad enough goes some way to ensuring that politicians keep things from going terribly wrong.

To recap, decentralization tends to improve government since it allows (or forces) regions to compete with one another in providing the best value for money in local services. In the marketplace, competition usually improves quality and reduces prices; in local government, competition provides the same sort of benefits.

### 3.2.2 From theory to practice

The five points discussed above provide principles rather than precise guidelines. The situation with respect to particular policies can be extremely complex, making it difficult or impossible to determine the 'correct' level of government for each task. Such debate inevitably turns on personal judgements and so takes us into an area in which economists have no particular advantage. Be that as it may, it is interesting to speculate briefly on how our framework helps us to think about the EU's actual allocation of tasks between the EU level and national level.

The one thing that is clear is that subsidiarity is probably a good idea. When in doubt, allocate the task to the lowest practicable level since higher-level decisions are less subject to democratic control via voice and exit. Going further is trickier.

In the EU, the main area of centralization has been economic policies, especially policies affecting the Single Market. As the discussion in Chapter 2 showed, virtually every policy that directly affects the competitiveness of particular industries is subject to control at the EU level. For example, import taxes, government subsidies (called state aid in EU jargon), exceptional tax benefits and anti-competitive behaviour by firms are subject to EU-wide rules that are enforceable in the European Court. The thinking here is that such policies are marked by important and systematic negative spillovers. When one EU nation subsidizes its firms in a particular industry, firms in other EU nations suffer from the artificially intensified competition. As in the tax example above, a likely outcome is a Prisoners' Dilemma – all EU nations end up providing subsidies, but the subsidies cancel one another out. Likewise, each nation might be tempted to introduce idiosyncratic product regulation in an attempt to favour local firms, but the end result would be a highly fragmented European market with too many small firms (see Chapter 6 for an analysis of the economics of this situation).

The exceptions to centralization in economic policy can also be understood in the light of our five principles. The EU does not attempt to harmonize most social policies or general labour market policies. Nor does it centralize decision making on general taxes, such as income taxes and corporate taxes. General policies like these do not necessarily affect the competitiveness of particular firms and so are subject to a much lower level of negative spillover. Moreover, national preferences for such policies are very diverse. In Spain, for example, the primary form of labour market protection for workers is employment protection legislation, that is, laws that make it difficult to fire workers. Germany relies much more on unemployment benefits. Given this divergence of national preferences, the losses from a one-size-fits-all policy would be likely to outweigh any gains in efficiency or avoidance of negative spillovers. Of course, one can argue with this and it is impossible to settle the argument scientifically. For example, German labour unions insisted that nationalized, one-size-fits-all wage bargaining should also apply to the eastern *Länder* despite the great diversity of economic conditions, and they insisted on the same homogeneity of labour market laws.

Most non-economic policies are decided at the national level. Of course, various nations cooperate on some of these policies – a good example is the agreement between France, Germany, Spain and the UK to produce a common military transport plane – but the decision making is allocated to the national level and cooperation is voluntary.

Roughly speaking, Single Market policies are where there are important spillovers; where national preferences are not too great and common policies tend to benefit from scale economies. The theory of fiscal federalism thus helps us to organize our thinking about why such policies are centralized.

Common foreign and security policies are marked by enormous scale economies and this would suggest centralization was best, but national preferences are enormously different among EU members. For example, unifying all of Europe's armies would result in a truly impressive force and allow Europe to develop world-class weapon systems. However, some EU members – France for example – have a long history of sending their young men to die in foreign lands for various causes. Other EU members – such as Sweden and Ireland – shun almost any sort of armed conflict outside their own borders. Given this diversity of preferences, the gains from scale economies would be more than offset by adopting a one-size-fits-all policy. Because of this, the only common EU policies in these areas are those arrived at by common consent, that is, by cooperation rather than centralization.

Other policies tend to lie somewhere between, both in terms of the gains from scale economies and in terms of the diversity of preferences. As discussed above, many Europeans find themselves, or their pensions, or their marriages, or their land purchases subject to multiple legal jurisdictions. Thus the uncoordinated nature of such national laws is increasingly creating negative spillovers. Moreover, as Europeans' incomes converge upwards, there is a strong tendency for the differences in their regulatory preferences to converge. Both reasons – narrower preference differences and more people affected by negative spillovers – can be taken as the underlying reason why the Lisbon Treaty essentially merged the old first and third pillars. As explained in Chapter 2 in detail, it did so by formally removing the pillars, but it maintained a sharp distinction between supranational and intergovernmental areas of cooperation by specifying the nature of the cooperation that applies article-by-article in the Treaties.

### 3.3 Economic view of decision making

The previous sections looked at factors affecting the allocation of tasks between the EU and its Member States. This abstracted from the actual process by which EU-level decisions are made. In other words, we simplified away the question of how decisions were made at the EU level in order to study the issue of which decisions should be made at the EU level.

In this and subsequent sections we reverse this simplification, focusing on the question of how the EU makes decisions. In particular, we shall concentrate on how the decision-making mechanisms affect the EU's ability to act, the distribution of power among EU nations and democratic 'legitimacy'.

Efficiency, power and legitimacy are inherently vague concepts. To make progress, we adopt the tactic of progressive complexity. That is, we start by taking what may seem to be a very shallow view of political actors and their motives. These simplifying assumptions allow us to develop some very precise measures of efficiency, legitimacy and national power in EU decision making. The benefit is that these precise measures permit us to comment on how efficiency and legitimacy have evolved in the EU – focusing on how they evolved with the 2004 and 2007 enlargements, and how they will evolve when Britain is no longer a member.

Before turning to the measures, however, we consider the decision-making rules in detail.

#### 3.3.1 Qualified majority voting

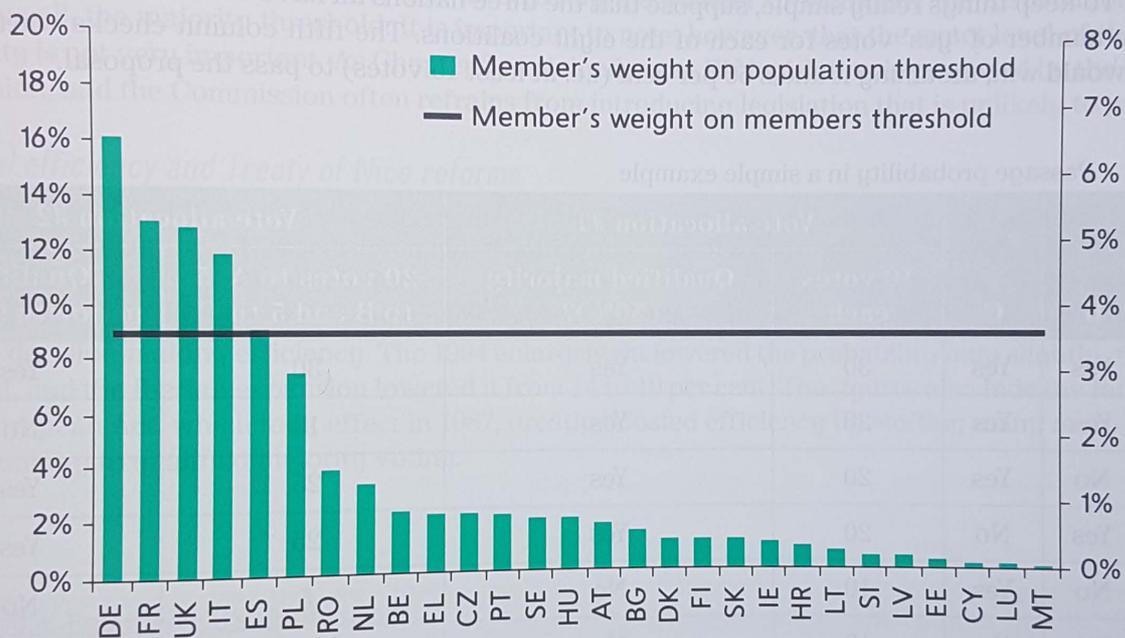
The EU has several different decision-making procedures but the main one is the 'ordinary legislative procedure' discussed in Chapter 2. This requires the Council to adopt the legislation by 'qualified majority voting' (which is universally known as QMV). The European Parliament, by contrast, adopts laws by a simple majority. As the Parliament's voting is straightforward – the usual 50 per cent majority threshold with one vote per Member of Parliament – we focus on the Council's voting rules.

The rules governing Council voting are set out in the Lisbon Treaty. They are based on the notion of a 'double majority'. That is, to pass, a proposal must pass a threshold in terms of the number of nations voting 'yes', and the population share of the yes voters. The result is a double majority in the sense that a sufficiently large share of EU nations, who represent a sufficiently large share of EU citizens, must approve. The number-of-members threshold is 55 per cent; the share-of-population threshold is 65 per cent.

This double majority approach is easy to think about once the reader realizes that each nation is casting one vote, but the vote is weighted in two different ways. On the number of votes criteria, where the threshold is 55 per cent, each vote has equal weight, which with 28 members, means each vote has a weight of 1/28, or about 3.6 per cent. On the share of population criteria, where the threshold is 65 per cent, the country's weight is its share of the EU population. Both of these are shown in Figure 3.3.

What is clear from the diagram is that a small country's vote, say that of Malta, does not really matter at all for the share-of-population threshold, but when it comes to the number-of-members threshold, Malta matters as much as Germany. The clout of each nation is some sort of blend of its weight in the two majority thresholds. As it turns out, political scientists have devised some simple ways of combining the two into a single measure of voting power. But before we get to that, we look at how easy it is to make decisions with this voting system.

**Figure 3.3** Member's voting weight under the 'double majority' QMV system.



Note: Based on information in the Lisbon Treaty.

### 3.3.2 EU ability to act: decision-making efficiency

From the mid-1990s right up until the Lisbon Treaty, EU leaders struggled to reform EU institutions in preparation for eastern enlargement – specifically the addition of 13 new members to an existing club of what was called the EU15. The process is now complete and the Lisbon Treaty has created a new QMV procedure as mentioned. The goal of this long series of reform attempts was to keep the EU's decision-making procedures 'efficient' and democratically legitimate. So did the Lisbon Treaty accomplish this goal?

In economics, 'efficiency' usually means an absence of waste. In the EU decision-making context, the word has come to mean 'ability to act'. While 'ability to act' is more specific than efficiency, it is still a long way from operational. For instance, on some issues the EU finds it very easy to make decisions, yet on others it finds it impossible to find a coalition of countries that would support a particular law. The perfect measure of efficiency would somehow predict all possible issues, decide how the members would line up into 'yes' and 'no' coalitions, and use this to develop an average measure of how easy it is to get things done in the EU. Such predictions, of course, are impossible given the uncertain and ever-changing nature of the challenges facing the EU.

An alternative approach, which we shall study here, sounds strange at first, but is really the best way of thinking systematically about the issue. Rather than trying to predict details of decision making on

particular topics, we adopt a 'veil of ignorance'. That is, we focus on a randomly selected issue – random in the sense that no EU member would know whether it would be for or against the proposition. It is a sort of 'veil of ignorance' approach.

### A quantitative measure of efficiency: passage probability

The specific measure we focus on is called the 'passage probability'. The passage probability measures how easy it is to find a majority under a given voting scheme. Specifically, it is the number of all possible winning coalitions divided by the number of all possible coalitions. The idea is that, if each conceivable coalition of voters is equally likely, then the measure tells us the likelihood of approving a randomly selected issue; that is why it is called the passage probability. The idea behind assuming all coalitions are equally likely is that, on a randomly selected issue, each voter is as likely to say 'yes' as he or she is to say 'no'.

To explain this concept, consider a simple example. Suppose there are only three voters, whom we call A, B and C. The first step is to identify all possible coalitions, that is, all possible arrays of 'yes' and 'no' votes. With three voters, there are eight possible coalitions. All eight are listed in the first three columns of Table 3.2. To keep things really simple, suppose that the three nations all have 10 votes. The fourth column shows the number of 'yes' votes for each of the eight coalitions. The fifth column checks whether each coalition would win, assuming it takes 50 per cent (i.e. at least 15 votes) to pass the proposal.

**Table 3.2** Passage probability in a simple example

A	B	C	Vote allocation #1		Vote allocation #2	
			10 votes each	Qualified majority (50%)?	20 votes to A, 5 to B and 5 to C	Qualified majority (50%)?
Yes	Yes	Yes	30	Yes	30	Yes
No	Yes	Yes	20	Yes	10	No
Yes	No	Yes	20	Yes	25	Yes
Yes	Yes	No	20	Yes	25	Yes
No	No	Yes	10	No	5	No
Yes	No	No	10	No	20	No
No	Yes	No	10	No	5	No
No	No	No	0	No	0	No
Passage probability (50% majority threshold) (%)				50.0		37.5
Passage probability (70% majority threshold) (%)				12.5		37.5

The passage probability is calculated in the second to last row. With the simple equal vote allocation #1, half of all possible coalitions pass the proposal, so the passage probability is 50 per cent.

To illustrate the usefulness of the passage probability concept, consider what would happen to this organization's ability to act if the allocation of votes became more concentrated, but there was no change in the majority threshold. For example, say that nation A now has 20 votes and nations B and C only 5 each. Just thinking intuitively, one would be hard put to form a judgement on whether the shift from 10 votes each to the 20, 5, 5 allocation would make it harder or easier to pass a random proposal. With the

passage probability, however, we see that the second allocation of votes leads to fewer ways of forming a winning coalition and so the change in vote allocation reduces decision-making efficiency.

The second thing that affects the passage probability is the majority threshold. It is intuitively obvious that raising the threshold makes it harder to find a coalition. Comparing the last two rows confirms this intuition. For vote allocation #1, raising the threshold from 50 per cent (i.e. 15 votes) to 70 per cent (21 votes) lowers the passage probability from 50 to 12.5 per cent. However, the details matter. Note that under allocation #2, the higher threshold does not make it any harder to find winning coalitions. The point is that there are no coalitions with a number of votes that lies between the old threshold (15 votes) and the new higher threshold (21 votes).

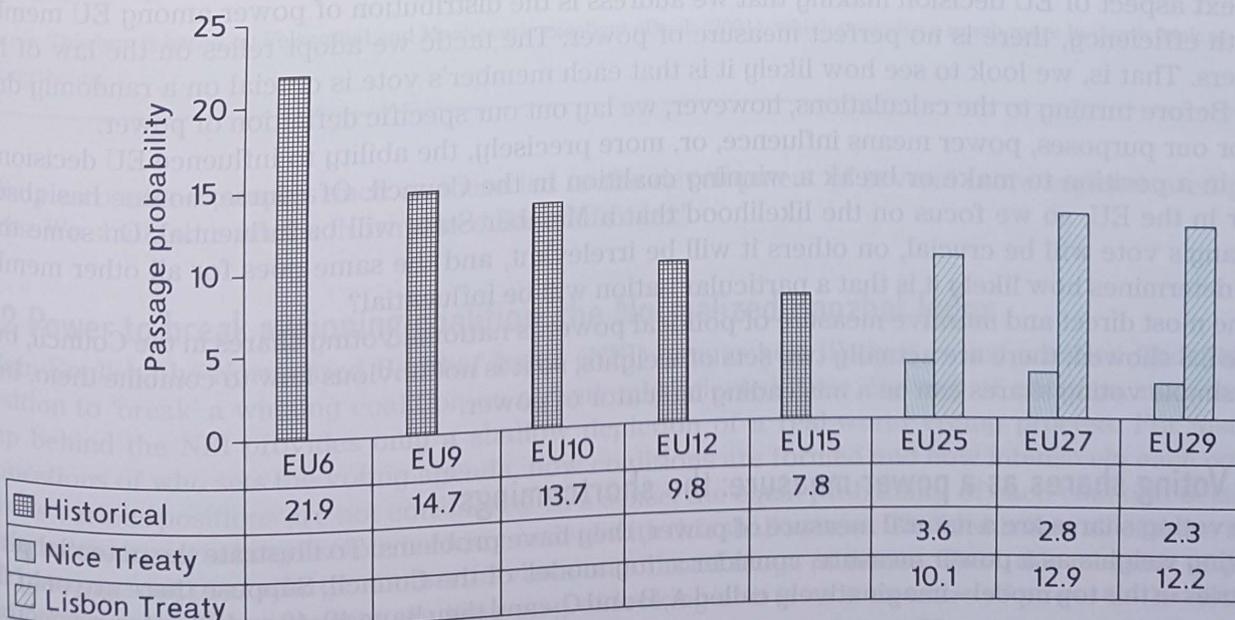
When looking at the real EU Council, the principle is the same, but the calculations are much, much more tedious. The main point is that the number of possible yes/no coalitions among 28 votes is 2 raised to the power of 28, which is a very big number – over 268 million. Given today's computers, that is not a particularly difficult calculation but one does need the right software (which readers can find on the internet easily).

The level of the passage probability is affected by the number of members, the distribution of votes and, above all, the majority threshold. It is important to note, however, that the exact level of the passage probability is not very important. As Chapter 2 explained, most EU legislation is proposed by the European Commission, and the Commission often refrains from introducing legislation that is unlikely to pass.

### Historical efficiency and Treaty of Nice reforms

We start by looking at how the EU's efficiency has changed over time. Above all, it is interesting to see how enlargement affects the EU's decision-making efficiency. The five left-most bars in Figure 3.4 show the passage probability for qualified majority voting (QMV) in the historical EUs with 6, 9, 10, 12 and 15 members. These indicate that, although efficiency has been declining, past enlargements have only moderately hindered decision-making efficiency. The 1994 enlargement lowered the probability only slightly, from 10 to 8 per cent, and the Iberian expansion lowered it from 14 to 10 per cent. The figures also hide the fact that the Single European Act, which took effect in 1987, greatly boosted efficiency by shifting many more decisions from unanimity to qualified majority voting.

Figure 3.4 Enlarged EU's ability to act



Source: Based on data from Baldwin and Widgrén (2007).

Notice that the 2004 enlargement greatly reduces the passage probability. This is true even with the Nice Treaty voting reforms (which were supposed to maintain the enlarged EU's ability to act). In fact, the Nice Treaty's complex rules made matters slightly worse than they would have been with no reform at all. The results show that accepting 12 newcomers without reform would dramatically reduce efficiency, cutting the current passage probability by something like a third, from 7.8 to 3.6 per cent.

This point, which became widely accepted after 2001, was why EU leaders asked the European Convention to reconsider the EU's decision-making rules – the request that eventually led to the Lisbon Treaty's new double-majority rule for the Council. Note that the decision-making rules in the Parliament and Commission were not viewed as problematic and thus were not reformed in the Constitution or the Lisbon Treaty.

### *The role of the Commission and Parliament*

In the mainstay legislative process, the ordinary legislative procedure (i.e. the old codecision procedure), both the Commission and the Parliament play critical roles. But they do not really affect decision-making efficiency.

The Commission proposes legislation and drafts the first version. This gives it a good deal of power, as will be discussed in more depth below. But it has always had this power, so the increasing difficulty of passing EU legislation is not related to the Commission's role. A more plausible link would be with the enlargement of the European Parliament. After all, if enlarging the Council makes it harder to pass laws, doesn't enlarging the Parliament do the same thing?

To address this, it is necessary to realize a special feature of the 50 per cent majority rule that the Parliament uses. When the winning coalition needs only half the votes, the passage probability is unrelated to the number of voters. Upon reflection, this is obvious. There is an almost unfathomable number of possible yes/no coalitions in the 785-member Parliament ( $2$  raised to the power of  $785$  is something like  $2$  with  $236$  zeroes after it), but when you only need half to win, it is clear that half of all coalitions will be winners. Thus the passage probability is always 50 per cent regardless of the number of voters.<sup>2</sup> This is why we can ignore the Parliament when considering the passage probability.

Of course, in the real world things are much more complex than the passage probability, but this concept provides a good point of departure for judging how various things like enlargement and voting reform can affect the EU's capacity to act.

## 3.4 The distribution of power among EU members

The next aspect of EU decision making that we address is the distribution of power among EU members. As with efficiency, there is no perfect measure of power. The tactic we adopt relies on the law of large numbers. That is, we look to see how likely it is that each member's vote is crucial on a randomly drawn issue. Before turning to the calculations, however, we lay out our specific definition of power.

For our purposes, power means influence, or, more precisely, the ability to influence EU decisions by being in a position to make or break a winning coalition in the Council. Of course, no one has absolute power in the EU, so we focus on the likelihood that a Member State will be influential. On some things Germany's vote will be crucial, on others it will be irrelevant, and the same goes for all other members. What determines how likely it is that a particular nation will be influential?

The most direct and intuitive measure of political power is national voting shares in the Council, but as Figure 3.3 showed, there are actually two sets of weights, so it is not obvious how to combine them. In any case, simple voting shares can be a misleading indicator of power.

### 3.4.1 Voting shares as a power measure: the shortcomings

While voting shares are a natural measure of power, they have problems. To illustrate the potential pitfalls of voting weights as a power measure, consider a 'toy model' of the Council. Suppose there are only three countries in this toy model – imaginatively called A, B and C – and they have 40, 40 and 20 votes, respectively.

<sup>2</sup> This is not exactly true with an odd number of voters but the difference is negligible.

Decisions are based on a simple majority rule (+50 per cent to win). If we used voting weights as a measure of power, we would say that countries A and B, each with their 40 votes, were twice as powerful as C with its 20 votes. This is wrong.

With a bit of reflection you can convince yourself that all three nations are equally powerful in this toy Council. The point is that any winning coalition requires two nations, but any two nations will do. Likewise, any pair of nations can block anything. As a consequence, all three nations are equally powerful in the sense that they are equally likely to make or break a winning coalition.

The level of the majority threshold can also be important in terms of power. For example, continuing with our toy model, raising the majority rule from 50 to 75 per cent would strip nation C of all power. The only winning coalition that C would belong to is the grand coalition A&B&C, but here C would not be able to turn it into a losing one by leaving the coalition. Therefore C's vote can have no influence on the outcome. Again, voting shares in this example would give a very incorrect view of power.

More generally, power – that is, the ability to make or break a winning coalition – depends upon a complex interaction of the majority threshold and exact distribution of votes. Indeed, the useless-vote situation in which nation C found itself in our second example actually occurred in the early days of the EU. See Box 3.4 for details.

### Box 3.4 Luxembourg's useless vote, 1958–73

The 1957 Treaty of Rome laid down the rules for qualified majority voting in the EEC6. The big three – Germany, France and Italy – got four votes each, Belgium and the Netherlands got two each, and Luxembourg got one. The minimum threshold for a qualified majority was set at 12 of the 17 total votes.

A little bit of thought shows that the Treaty writers did not think hard enough about this. As you can easily confirm, Luxembourg's one vote never matters. Any coalition (group of 'yes' voters) that has enough votes to win can always win with or without Luxembourg. According to formal power measures, this means that Luxembourg had little power over issues decided on a QMV basis. As Felsenthal and Machover (2001) write: 'This didn't matter all that much, because the Treaty of Rome stipulated that QMV would not be used until 1966; and even in 1966–72 it was only used on rare occasions. Still, it seems a bit of a blunder.' It all changed post-1973, when the weights were altered to allow for the accession of Britain, Denmark and Ireland. Indeed, since then Luxembourg's votes have turned out to be crucial in a surprisingly large number of coalitions. Maybe that is why Luxembourg has the highest receipt per capita in the EU despite being the richest nation by far.

*Source:* This box is based on Felsenthal and Machover's excellent eBook (2001), which provides a much more in-depth look at voting theory.

Simple counter-examples such as these led to the development of several more sophisticated power indices. We shall focus on the 'Normalized Banzhaf Index'.

#### 3.4.2 Power to break a winning coalition: the Normalized Banzhaf Index

In plain English, the Normalized Banzhaf Index (NBI) gauges how likely it is that a nation finds itself in a position to 'break' a winning coalition on a randomly selected issue. By way of criticism, note that the set-up behind the NBI provides only a shallow depiction of a real-world voting process. For instance, the questions of who sets the voting agenda, how coalitions are formed and how intensively each country holds its various positions are not considered. In a sense, the equal probability of each coalition occurring and each country switching its vote is meant to deal with this shallowness. The idea is that all of these things would average out over a large number of votes on a broad range of issues. Thus, this measure of power is really a very long-term concept. Another way of looking at it is as a measure of power in the abstract. It tells us how powerful a country is likely to be on a randomly chosen issue. Of course, on particular issues, various countries may be much more or much less powerful.

The easiest way to understand this concept more deeply is to calculate it for our simple example in Table 3.2. To make it interesting, we take the uneven vote allocation case (#2) and assume a 70 per cent majority threshold, so winning takes 21 votes. As before, we line up all eight possible coalitions and decide which are the winning ones (Table 3.3). These are the first three. Then we ask who the critical players are in these winning coalitions – critical in the sense that they would turn the winning coalition into a losing coalition if they changed their vote. In the first coalition, only A is critical since the defection of either B or C would not change the outcome; nation A and the remaining other nation would have enough votes to win. In the second and third coalitions, where the majority is narrower, both nations are critical, namely, A and C in the second and A and B in the third.

**Table 3.3** Critical players with a 70 per cent majority threshold

A	B	C	Yes votes	70% majority?	Critical player(s)
Yes	Yes	Yes	30	Yes	A
Yes	No	Yes	25	Yes	A, C
Yes	Yes	No	25	Yes	A, B
Yes	No	No	20	No	
No	Yes	Yes	10	No	
No	No	Yes	5	No	
No	Yes	No	5	No	
No	No	No	0	No	

Thus there are five situations in which a nation would find itself critical. Nation A finds itself in this situation three of the five times, while B and C are critical in only one of the five times. Thus, in this sense, A is more powerful than B and C. The NBI for A is three-fifths, while it is one-fifth for B and C.

The calculation of NBI for all EU members is a topic that may fascinate some readers, but it is not essential to our study of EU decision making, so we relegate its discussion to Box 3.5.

### Box 3.5 Calculating the Normalized Banzhaf Index (NBI)

The mechanical calculation of the NBI is easy to describe and requires nothing more than some patience and a PC with lots of horsepower. To work it out, one asks a computer to look at all possible coalitions (i.e. all conceivable line-ups of 'yes' and 'no' votes) and identify the winning coalitions. Note that listing all possible coalitions is easy to do by hand for low numbers of voters; in a group of 2 voters there are only 4, in a group of 3 there are 8. However, the general formula for the number of all possible coalitions for a group of  $n$  voters is  $2^n$ , so determining which coalitions are winners by hand quickly becomes impractical; in the EU15, 32,768 coalitions have to be checked. In the EU28, the number is over 268 million. The computer's next task is to work out all the ways that each winning coalition could be turned into a loser by the defection of a single nation. Finally, the computer calculates the number of times each nation could be a 'deal breaker' as a fraction of the number of times that any country could be a deal breaker. The theory behind this is that the Council decides on a vast array of issues, so the NBI tells us how likely it is that a particular nation will be critical on a randomly selected issue.

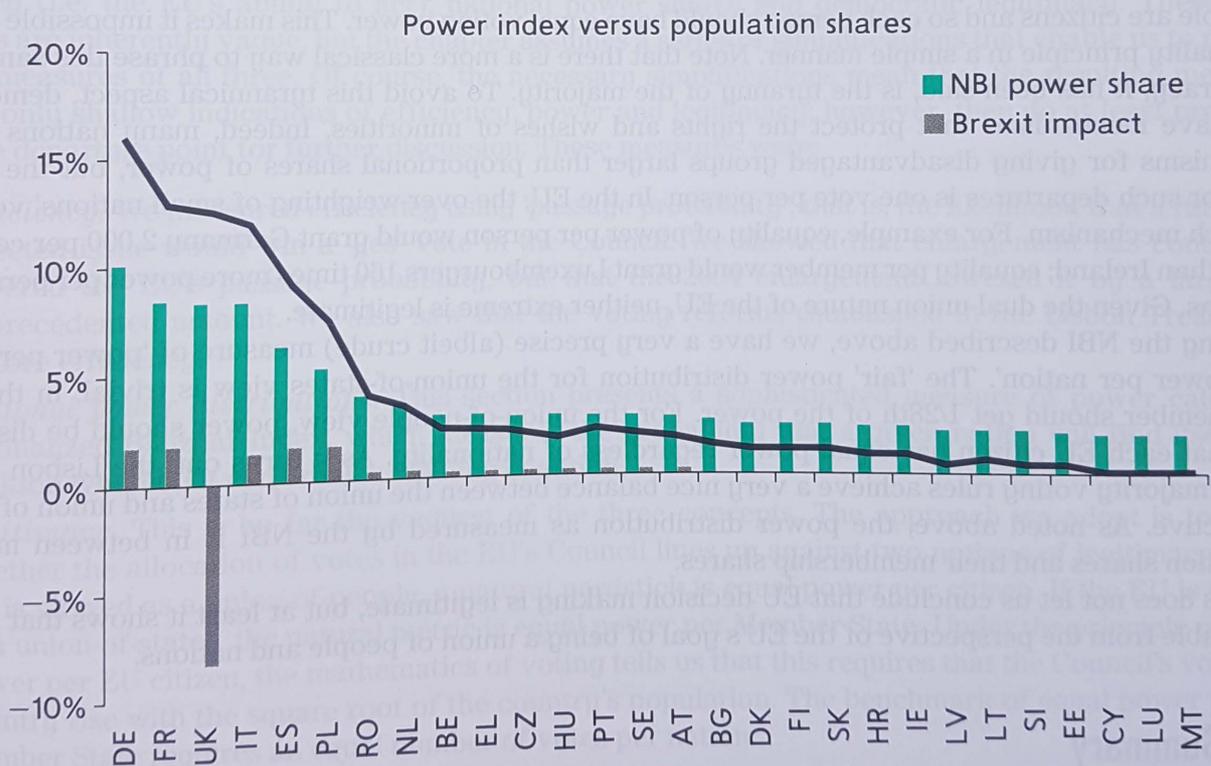
### 3.4.3 Power shifts from Brexit

When the UK leaves, the power shares of all remaining nations will change since both the population-shares and the member-shares will change for everyone. One very useful application of our quantitative power measure concerns the impact of Brexit on the distribution of power of the remaining 27 members.

We start with the distribution of power in the EU28 under the Lisbon Treaty's double majority rule for QMV, using the NBI to measure the shares of power held by each member. Figure 3.5 shows the NBI and compares it to the population shares of members. What the figure shows is that, as mentioned above, the power share of members is something like a blend of the population share and the member share, which is the same for all members. This makes a lot of sense intuitively.

For share members whose population shares are negligible, the double majority system is basically a single majority system where only the member share vote matters. The power shares for all the small countries are thus quite similar and range between 2 and 3 per cent. That is, below the membership share (3.6 per cent for everyone). For the big nations, the main determinant of their power is the population share, so the NBI power share rises steeply along with their population share, but of course it is below their population share since the number-of-members threshold also matters.

**Figure 3.5** Power shares of EU28 and changes from Brexit.



Note: The Council voting rules in the Lisbon Treaty are identical to those in the rejected Constitution.

Source: Based on data from Eurostat, and Kirsch (2016).

Figure 3.5 also shows the answer to the question: How will Brexit affect the power distribution in the Council of Ministers? The answer is very clear and very simple. The UK's power share, which was about 8 per cent in the EU28 will be distributed more or less evenly among all the large members, namely Germany, France, Italy, Spain and Poland. The impact on all the other members is negligible. It is slightly positive in the small nations, and slightly negative in the tiny and minuscule nations.

### 3.5 Legitimacy in EU decision making

The EU is a truly unique organization. Nowhere else in the world has so much national sovereignty been transferred to a supranational body. As Chapter 1 pointed out, the massive death and destruction from two world wars is what led the EU's founders to contemplate this transfer, but the continual willingness of the current generation of Europeans to accept it depends upon much more practical considerations. One consideration is the EU's ability to deliver results, but another important consideration is the democratic legitimacy of the EU's decision-making process.

#### 3.5.1 Thinking about democratic legitimacy

What makes a decision-making system legitimate? This is a difficult question so it helps to start with an extreme and obviously illegitimate voting scheme and to think about why it seems illegitimate. Almost every European would view as illegitimate a system that allowed only landowning males the right to vote. Why? Because those without votes would find it unjust. And if the landowning men were forward looking, they would also find it illegitimate since they or their male offspring might one day lose their land. In short, a good way to think about legitimacy is to apply the 'in the other person's shoes' rule. A system is legitimate if all individuals would be happy with any other individual's allocation of voting power, which, if you think about it, requires equality. Equal power per citizen is thus a very natural legitimacy principle.

But what constitutes a citizen? In the EU there are two answers: nations and people. The EU is a union of states, so each state is a citizen and should thus have equal voting power. The EU is also a union of people, so people are citizens and so each person should have equal voting power. This makes it impossible to apply the equality principle in a simple manner. Note that there is a more classical way to phrase this same point. Democracy, it has been said, is the tyranny of the majority. To avoid this tyrannical aspect, democracies must have mechanisms that protect the rights and wishes of minorities. Indeed, many nations provide mechanisms for giving disadvantaged groups larger than proportional shares of power, but the starting point for such departures is one vote per person. In the EU, the over-weighting of small nations' votes was one such mechanism. For example, equality of power per person would grant Germany 2,000 per cent more power than Ireland; equality per member would grant Luxembourgers 160 times more power per person than Germans. Given the dual-union nature of the EU, neither extreme is legitimate.

Using the NBI described above, we have a very precise (albeit crude) measure of 'power per person' and 'power per nation'. The 'fair' power distribution for the union-of-states view is trivial; in the EU28, each member should get 1/28th of the power. For the union-of-people view, power should be distributed such that each EU citizen has equal power regardless of nationality. As it turns out, the Lisbon Treaty's double majority voting rules achieve a very nice balance between the union of states and union of peoples perspective. As noted above, the power distribution as measured by the NBI is in between members' population shares and their membership shares.

This does not let us conclude that EU decision making is legitimate, but at least it shows that it seems reasonable from the perspective of the EU's goal of being a union of people and nations.

### 3.6 Summary

Just to continue to operate, the EU must make a steady stream of decisions to adjust to the ever-changing economic and political landscape. This chapter looked at the EU decision-making process from two perspectives. First, it considered the EU's current allotment of 'competences' between the EU and national government levels. In terms of actual practices and principles, the key points were:

- Policy making is categorized into areas in which the EU has 'exclusive competence', that is, where the decision is made only at the EU level; areas in which competence is shared; areas in which the EU can undertake supporting, coordinating or complementary actions; and areas in which the EU has no competence, that is, where decisions are made only at the national or subnational level.
- The allocation of policy areas to these categories is determined by the Treaties and, when necessary, by decision of the European Court. This allocation, however, is blurred since the Treaties do not always refer to specific fields. Sometimes they refer only to areas by functional description, for

example the internal market, which themselves are only vaguely defined (or at least vague from a legalistic perspective). To clarify the allocation, the EU operates on the principle of subsidiarity and proportionality, which says that unless there is a good reason for allocating a task to the EU level, all tasks should be allocated to national or subnational governments, and even then the EU should take only the minimum necessary action. The old three-pillar structure of the EU helped to clarify the allocation; namely, first-pillar (Community pillar) issues were under EU competences while second- and third-pillar issues were not. The Lisbon Treaty removed the pillars, but essentially merged the old first and third pillar into one supranational area while keeping the old second pillar (foreign and defence policy) as intergovernmental.

The chapter also presented a framework for thinking about how tasks should be allocated between various levels of government (theory of fiscal federalism). This framework stresses four trade-offs that suggest whether or not a particular decision should be centralized:

- 1 Diversity and information costs favour decentralized decision making
- 2 Scale economies favour centralization
- 3 Democracy-as-a-control-device favours decentralization
- 4 Jurisdictional competition favours decentralization.

The second part of the chapter considered the EU decision-making process in more detail, focusing on efficiency (i.e. the EU's ability to act), national power shares and democratic legitimacy. These three concepts are inherently vague, but the chapter assumes a series of simplifications that enable us to present precise measures of all three. Of course, the necessary simplifications mean that the resulting measures provide only shallow indications of efficiency, power and legitimacy; however, they do at least provide a concrete departure point for further discussion. These measures were:

- *Efficiency.* We measured efficiency using 'passage probability', that is, the likelihood that a randomly selected issue would win a 'yes' vote in the Council. We showed that enlargement has continually lowered the EU's passage probability, but that the 2004 enlargement lowered it by a large and unprecedented amount. We also saw that the voting reforms established in the Lisbon Treaty help restore efficiency.
- *National power distributions.* This section presents a sophisticated measure of power called the Normalized Banzhaf Index, which measures the probability that a given nation will find itself in a position whereby it can break a winning coalition.
- *Legitimacy.* This is by far the vaguest of the three concepts. The approach we adopt is to check whether the allocation of votes in the EU's Council lines up against two notions of legitimacy. If the EU is viewed as a union-of-people, a natural yardstick is equal power per citizen. If the EU is viewed as a union-of-states, the natural metric is equal power per Member State. Under the principle of equal power per EU citizen, the mathematics of voting tells us that this requires that the Council's votes per country rise with the square root of the country's population. The benchmark of equal power per EU Member State requires an equal number of votes per nation.

## Self-assessment questions

- 1 List the main trade-offs stressed by the theory of fiscal federalism. Discuss how the tension between negative spillovers and diversity can explain the fact that the EU has adopted only very limited harmonization of social policies.
- 2 In many European nations, the trend for the past couple of decades has been to decentralize decision making from the national level to the provincial or regional level. How could you explain this trend in terms of the theory of fiscal federalism?

- 3 Using the actual Council votes in the Lisbon Treaty, list five blocking coalitions that you might think of as 'likely'.
- 4 The formal power measure discussed in the chapter assumes that each voter has an equal probability of saying 'yes' or 'no' on a random issue, and that the votes of the various voters are uncorrelated. That is, the likelihood that voter A says 'yes' on a particular issue is unrelated to whether voter B says 'yes'. However, in many situations, the votes of a group of voters will be correlated. For example, poor EU members are all likely to have similar views on issues concerning spending in poor regions. Work out how this correlation changes the distribution of power (defined as the likelihood that a particular voter can break a winning coalition). To be concrete, assume that there are five voters (A, B, C, D and E), each has 20 votes, the majority rule is 51 per cent and A and B always vote the same way.
- 5 Using the definition of legitimacy proposed in the text (equal power per person), try to determine whether the US Congress is 'legitimate'. Note that the US Congress has two houses: the Senate and the House of Representatives. In the Senate, each of the 50 states has two Senators, while the number of Representatives per state is proportional to the state's population.

## References and further reading

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### Further reading: the aficionado's corner

- Baldwin, R.** (2007) 'Stranger than fiction: The voting rules in the Reform Treaty are a victory for Poland', VoxEU.org, 24 June 2007.
- Bindseil, U. and C. Hantke** (1997) 'The power distribution in decision making among EU Member States', *European Journal of Political Economy*, 13, 171–85.
- Kauppi, H. and M. Widgrén** (2004) 'What determines EU decision making? Needs, power or both?', *Economic Policy*, 19(39), 221–26.

More wide-ranging introductions to fiscal federalism applied to the European Union can be found in:

- Berglof, E., B. Eichengreen, G. Roland et al.** (2003) *Built to Last: A Political Architecture for Europe*, CEPR Monitoring European Integration 12, CEPR, London.
- Dewatripont, M., F. Giavazzi, J. von Hagen et al.** (1995) *Flexible Integration: Towards a More Effective and Democratic Europe*, CEPR Monitoring European Integration 6, CEPR, London.

The latter includes a general discussion that applies the theory to the Constitutional Treaty.

For an opinionated view on what decisions should be allocated to the EU, see:

- Alesina, A. and R. Wacziarg** (1999) *Is Europe Going too Far?*, Carnegie-Rochester Conference on Public Policy. Although this contains several factual errors concerning EU law and policies, it provides a highly cogent application of the theory of fiscal federalism to decision making in the EU.

To learn more about formal measures of power and legitimacy, see:

**Felsenthal, D. and M. Machover** (2001) *Enlargement of the EU and Weighted Voting in the Council*, www.lse.ac.uk.

For historical power distributions, see:

**Laruelle, A. and M. Widgrén** (1998) 'Is the allocation of voting power among EU Member States fair?', *Public Choice*, 94, 317–39.

See also:

**Baldwin, R.** (1994) *Towards an Integrated Europe*, CEPR, London.

**Baldwin, R., E. Berglof, F. Giavazzi and M. Widgrén** (2001) *Nice Try: Should the Treaty of Nice be Ratified?*, CEPR Monitoring European Integration 11, CEPR, London.

**Begg, D., C. Wyplosz, A.J. Venables et al.** (1993) *Making Sense of Subsidiarity: How Much Centralization for Europe?* CEPR Monitoring European Integration 4, CEPR, London.

**Peet, J. and K. Ussher** (1999) *The EU Budget: An Agenda for Reform?*, CEPR Working Paper, February.

## Useful websites

Extensive explanation and use of formal voting measures can be found on the 'European Voting Games' website: <http://www.esi2.us.es/~mbilbao/eugames.htm>.

You can find software for calculating voting power indices at: <http://homepages.warwick.ac.uk/~eCAAe/index.html>.

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