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**Is a Federal European Constitution for an
Enlarged European Union Necessary?
Some Preliminary Suggestions using Public
Choice Analysis**

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Is a Federal European Constitution for an Enlarged European Union Necessary?

Some Preliminary Suggestions using Public Choice Analysis

Friedrich Schneider, Linz*

Abstract. In order to guarantee a further successful functioning of the enlarged European Union a Federal European Constitution is proposed. Six basic elements of a future European federal constitution are developed: the European commission should be turned into an European government and the European legislation should consist of a two chamber system with full responsibility over all federal items. Three further key elements are the subsidiarity principle, federalism and the secession right, which are best suited to limiting the domain of the central European authority to which certain tasks are given, such as defense, foreign and environmental policy. Another important feature is direct democracy, which provides the possibility for European voters to participate actively in the political decision making, to break political and interest group cartels, and to prevent an unwanted shifting of responsibilities from EU member states to the European federal level.

JEL-Classification: D72, D78, H7, H11

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1. Introduction

After successfully implementing the European Economic and Monetary Union we are currently realising two contradicting processes: a first process of reforming some EU-institutions and implementing a European constitution failed due to the behavior of selfish politicians and the rejection of this constitution in popular referenda through a vast majority of the French and Dutch voters in spring 2005. Second ten mostly former transition countries (e.g. Poland, Czech Republic, Hungary, Slovenia), entered the EU in May 2004. Since then we have an European Union with 25 members and two basic questions arise:

(1) which sound and sustainable financial system will be necessary and (2) in a more general context which basic constitutional reforms (possibly ending in a European Federal Constitution) are needed? 1) Due to the rejection of the European Constitution of the French and Dutch voters and the enlarged EU with 25 members the “old” EU arrangements do not guarantee a smoothly function of the institutions of the European Union with 25 quite different members, mainly different with respect to their economic development. Hence new institutional arrangements have to be developed and one possible reform step is a new but much less ambitious European Constitution¹. Without a mayor reform the new much larger EU could lead to a situation where the advantages of the EU are smaller than the disadvantages, with the consequence of destroying the EU. In order to avoid a major crisis of the functioning of this larger EU and the author proposes the idea, that, some (minimal) European federal union will be necessary.²

Hence, in this paper some elements of a federal European constitution, like subsidiarity, federalism, and direct democratic institution are suggested and justified with the help of constitutional economics. In part 2 six basic elements of a European constitution are introduced and in parts 3 to 5 an attempt is made to scientifically justify these propositions, like the design of European legislation (part 3), the subsidiarity and federalism principle (part

¹ The idea of an European Constitution is also discussed and mostly supported by various other researchers like Piris (2000), Feld (2003, 2005), Feld and Kirchgassner (2003), Blankart and Mueller (2003a,b), Vaubel (2004)

² Such a much less ambitious, smaller constitution, which takes the preferences of the European voters into consideration, has been developed by the European constitutional group, compare Bernholz, Schneider, Vaubel and Vibert (2004)

³ The author is convinced that a 25 member EU needs major reforms and even a minimal constitution – which can of course be debated, (see e.g. Piris (2000), Feld (2005), Blankart and Mueller (2003a,b)). The author of this paper supports the value judgment, that the EU should be transformed from a confederation to a minimal federation. Consequently this paper is a revised version of Schneider (2002), where the idea of a European Federal Union has been developed.

4), and direct democratic institutions (part 5). Finally part 6 provides a summary and gives some conclusions.

2. Six Basic Elements of a Future Federal European Constitution (FEC)

The successful completion of European Economic and Monetary Union provided the opportunity to achieve a number of efficiency gains, and it also provided the opportunity to stimulate the growth rates of EU economies. Furthermore, competition has been promoted between member states by having a single currency and by weakening state-owned monopolies (like power plants and telecommunication systems). However, there is also the danger that these positive influences would be weakened if national regulations were replaced by EU regulations, and even more important if a ‘new federal’ government at the EU level is ‘created’ without operating in a carefully designed institutional framework and with the consequence that it might grow and take over responsibilities from EU member states, which they do not want³

But then there should be careful considerations when creating such a Federal European constitution in order to prevent or limit a growing share of European federal government expenditures and the influence of interest groups. Buchanan (1990; pages 1 and 10) has already drawn attention in the early 90s to the fact that ‘...Europe is now presented with a historically unique opportunity The (constitutional) contract must be such as to ensure mutual gains from trade The only constitutional structure that is consistent with the historically constrained setting of the 1990s is that of a federal union ...’. Page 10 also stresses that ‘...a central political authority must come into power with some sovereignty over citizens in all of the nation-states’. According to Buchanan, it seems advisable to support the introduction of a Federal European Constitution (FEC).

It has already been stressed in Schneider (1993, 1996) and others (e.g. Mueller (2003)) that democratic systems with market economies, if unchecked, show a strong tendency towards increasing state activity at the highest level and interest group influence.⁴ As a consequence, the motivation of individuals to work efficiently, to engage in risky productive activities and to innovate, is dampened. Whereas the removal of intra-European barriers to the movement of

³ Compare Alesina and Perolti (1994), Alesina and Rodrick (1992), Kirchgaessner and Pommerehne (1995); Vaubel (1996), Voigt (2003), Feld (2005), consider also the current discussion about an European Constitution like in the European Constitutional Group (2003).

⁴ Compare the studies by Olson (1965), Bernholz (1990a,b), Schneider and Frey (1988), Peden and Bradley (1989), Weede (1986, 1990) De Haan and Siermann (1995, 1996).

people, goods, capital, and services might weaken the influence of special interest groups and bureaucracies in EU member states, a growth at the size of the expenditure at the federal European level has to be expected as soon as Europe-wide interest groups and parties have been fully established. A European constitution thus has to contain provisions to counterbalance such tendencies.

Also such a constitution is necessary in order to guarantee an efficient functioning of an European Union with 25 members, which will draw especially social attention to the Union's institutional framework. In particular, it is feared that the enlarged EU will dilute the Union's legislative activities and in the current political debate it is clearly argued that the functioning of this enlarged Union depends on the European Union's ability to reform its institutional framework in order to maintain efficiency as well as to regain the support of the European voters.⁵

An European Constitution is also needed, so that an European identity (at least) for certain issues which should be handled at the European level, can slowly grow or be formed. So far an European identity is rather weak if it does exist at all. It has begun to grow since the creation of the Euro but on average the European citizens feel primarily as French, Italians or Germans and not as Europeans. This is one of the major difficulties when making suggestions about an European Federal Constitution, because an European Constitution can only be last and will be accepted by European voters (citizens) if they think in an European way and only if they are convinced that such a Constitution is needed and helps to strengthen their rights.⁶ It is also difficult to create or strengthen an European identity as long as the European voters have a little or no influence in either changing the government or to participate in certain major decisions of the European Union like widening the European Union, like a change in the finances. Therefore, the following constitutional elements will support the idea of a slowly growing (and/or creating) European identity, f.e. by introducing direct democratic elements in such a constitution.⁷

The following elements could be an essential part of such a constitution:⁸

⁵ Necessary reforms of the EU are discussed in König and Bräuninger (1999); they concentrate on two aspects of institutional reform and functional as well as parliamentary integration. See also Tabellini (2003a, 2003b) and Vaubel (2003).

⁶ Compare e.g. Feld (2003, 2005) and Abromeit (1998).

⁷ Compare e.g. Feld (2003, 2005), Feld and Kirchgässner (2003); Blankart and Mueller (2003).

⁸ The justification of these six elements is given in the following points and for a more recent discussion of constitutional issues, see Gwartney and Wagner (1988), Vanberg and Buchanan (1989), Schneider (1993), Kirchgässner (1994) and Holzmann (1996); for fiscal federalism, Oates (1985), Blöchliger and R.L. Frey (1992), Eichenberger (1994), Feld (2005), Vaubel (2004)

I. The European Commission should be turned into a European government with strictly limited tasks (for instance, the ones set up in element 2), the Council of Prime Ministers and Presidents into a second chamber (European Council) where each country has the same weight of voting power. The simple majority approval of both chambers (the European Parliament and the European Council) is necessary for any legislation passed. Obviously, the European Parliament and the second chamber should solely have the full authority and responsibility for all European budgetary and federal items. If the two chambers cannot agree on a legislative or budgetary item, the parliament can overrule the decision of the second chamber by a qualified (for instance, 2/3) majority.

II. The jurisdiction of the European federal government should consist of defense, foreign policy, foreign trade policy, the enforcement of free intra-community movement (of people, goods, services and capital), anti-cartel and anti-monopoly policy and environmental policy concerning community-wide environmental problems. All these policy issues should only be taken over by the new European government if there is consensus between member states, that the highest federal unit should do it, and if a referendum over these issues is approved by simple majority of the European voters and by simple majority of the member states.

III. For the federal European government it should not be possible to run or accumulate deficits on its (current) budget over a legislative period. If a budget deficit still occurs at the end of a legislative period, either expenditures should be cut or revenues should be increased, given that the political conditions for a tax rate increase are fulfilled (compare elements 4 and 5) so that the budget will be balanced again. Longer (than a legislative period) lasting public debt at the European federal level should only be allowed for financing investment expenditures and only if the federal government has the financial capacity to pay the interest and amortization of the debt out of its current budget.⁹

IV. The activities of the Community should be financed by one specifically labeled tax, like a proportional (indirect) tax. Changes of the rate of this tax should be subject to 2/3 majority of the European parliament and of the second chamber, and to the approval of a popular referendum.

V. The institution of a popular referendum should be introduced for major policy issues (like a change of the European constitution, change of tax rate, etc.). Furthermore, a popular referendum should be held if a certain number of voters ask for it and if at least a certain

percentage of all people entitled to vote participate.¹⁰ The issue over which the referendum is held is only accepted if it is approved by simple majority of the European voters and by simple majority of the member states.

VI. EU member states should have the right to secede from the European federal union. A member state should, by qualified (2/3 or 3/4) majority vote of their population, be able to leave the European federal constitution to become an independent state once again. However, the political and all other procedures for the secession should be precisely fixed in advance and a transition period of a considerable length of time (e. g. 5 or 10 years) should be allowed. If an EU member state fails to reach such a qualified majority the next attempt should be possible after 20 years.

3. The Design of the European Legislation

As the first element in Section 2 proposes the formation of a European government with a two chamber system, the first chamber being the European parliament and the second chamber being the Council of Prime Ministers and Presidents, and obviously the control of both chambers over all federal items, which are delegated to the European Union, some general remarks will be made to justify this proposition. It is difficult to find studies analyzing the separation of powers from the perspective of positive constitutional economics. In a review article Posner (1987) argues that the separation of powers increases the transaction costs of governing. This would hold for welfare-enhancing as well as for redistributive or even exploitative measures. The concept of separation of powers can be classified into the horizontal separation (legislature, executive, judiciary) and vertical separation (federalism). The structure of isolated powers can vary to a considerable extent. Some progress has been made in analyzing the effects of separation of powers and political accountability. For example, Persson, Roland and Tabellini (1997) show in a formal principal-agent model that separation of powers improves the accountability of elected officials, and thereby the utility of voters, but only under appropriate checks and balances. Two central provisions are needed: (1) there must be a conflict of interest between the executive and the legislative. (2) Moreover it must be impossible to implement any policy unilaterally, i.e. without the consent of both bodies. The basis for these results lies in the modelling of real-world political constitutions as

⁹ Whether the European economic and monetary integration provides incentives to increase public deficits is investigated in Horstmann and Schneider (1994). Compare also Feld and Kirchgassner (1997).

'incomplete contracts': 'Elected politicians are not offered an explicit incentive scheme associating well defined payoffs with actions in all states of the world. Political constitutions only specify who has the right to make decisions, and according to which procedures for which circumstances. This makes it hard to tie specific rewards or sanctions to the contents of those decisions' (Persson, Roland and Tabellini: 1997, p.5). The application of these results to the European Union makes it necessary that institutions are created, which leave only limited leeway for European Politicians for selfish actions.

The various effects of unicameral and bicameral legislators were first analyzed from a public choice perspective by Buchanan and Tullock in their famous book *Calculus of Consent* in 1962. One of their major conclusions in their analytical framework is that the optimal decision rule is the one that leads to a minimum of the sum of external and decision costs (interdependence costs). Buchanan and Tullock (1962: p.235) conclude that in comparison with unicameral systems, bicameral systems have higher decision costs and continue ...'On the other hand, if the basis of representation can be made significantly different in the two houses, the institutions of bicameral legislature may prove to be an effective means of securing a substantial reduction in expected external cost of collective action without incurring as much added decision making cost as a more inclusive rule would involve in a single house'. The larger the majority required to reach a certain decision, the lower the external costs connected with that decision, because the number of opponents to a decision is negatively correlated with the required majority. On the other hand, it will become increasingly difficult to reach a decision at all, because the decision costs are positively correlated with a required majority.

In a more recent study Levmore (1992) investigated the advantages and disadvantages of a bicameral versus a unicameral system. He concludes that a bicameral system might be better suited than a corresponding qualified majority in a unicameral system, to reduce the power of the agenda setter (mostly the government). Bicameral systems are often interpreted as a 'break' against overly active legislatures. Summarizing the effects of bicameral systems, one could conclude that the legislative activities in a bicameral system are indeed lower than in a

¹⁰ The precise figures under which conditions a referendum has to be held and is accepted have to be specified the only important point is that the option exists to force the European government to hold a referendum over a certain issue.

unicameral one and this should be reflected in a lower government consumption of economic output and in higher growth rates.¹¹

Some papers in constitutional economics (see, for instance, Moser and Schneider, 1997) try to give an analysis of the consequences of a change in the procedure on the power of the European government organs.¹² Within the European Union, the strengthening of the European parliament can be attributed as a further safeguard in addition to the second chamber. A bicameral system is also demanded, since it reduces the capability of rent seeking, because it is much more difficult to get a majority in both chambers than in only one.¹³ This is especially important after the widening of the European Union, because the more member states the European Union has, the more likely rent seeking might occur. The draft report of the European Constitutional Group (1993, 2003, 2004) stresses the importance of competition as a mechanism to best fulfill consumer's preferences. Competition, however, is not only crucial for the working of economy; it is also needed in political markets, and the concept of institutional competition has a long tradition (starting with Tiebout's 'voting with the feet'). A better implementation of the distribution of powers, turning the Commission into a European government, the Council of Prime Ministers into a second chamber and strengthening the European parliament (which means giving these two chambers full legislative power), can be seen as a first step in applying the democratic principle to a European Union. This will be one way to reduce the political inefficiencies which are normally discussed when investigating the democratic deficit of the European Union.

4. The Subsidiarity and Federalism principles as safeguards against Government growth and Centralization Tendencies

4.1. The Subsidiarity Principle

One key element of a European federal union is a fixed set of tasks for the European federal government, which has to be carefully defined. This basic proposition comes from the idea of

¹¹ A similar conclusion is reached and preliminary empirical evidence is given by the studies of Feld and Kirchgässner (1996), Feld and Savioz (1997), and for a more general view of this aspect see Weingast (1995).

¹² Compare Peters (1996a and 1996b) and Steunenberg (1994).

¹³ The introduction of a bicameral system not only reduces attempts for rent seeking but is also important element in only to strengthen the federal structure of the European Union. The second chamber, in which the Prime Ministers and Presidents of every EU member state have equal voting power, can be seen as an institution which solely represents the interests of the EU member countries, like the German Bundesrat or the Schweizer Ständerat. It might especially help to take care of the interests of the quite larger number of the smaller EU member countries after the enlargement.

using the subsidiarity principle, which is in substance a constitutional norm. Vanberg (1994) argues that this norm is meant to provide a criterion for what can be considered as a desirable constitutional order, a criterion that concerns an allocation of political authority in a multilayer system of states/governments. To put it simply, the subsidiarity principle requires that in a multilevel policy the distribution of power should be in favour of lower level governments, and hence smaller jurisdictions. In other words, it demands that the political authority be always located at the lowest possible level, that is as close as possible to the citizens, the ultimate sovereign. Again, the consistent use of this principle is a necessary prerequisite for a functioning of a widened European Union in a productive way for all member states.

In the Commission report on the adaptation of existing legislation to the subsidiarity principle (European Commission 1999: p.545) one reads ‘... the aim of the subsidiarity principle is, to see to it that decisions are taken as close as possible to the citizen, a constant watch being kept to ensure that action taking at community level is justified in the light of the means available to national, regional or local authorities’. Of course, the phrase ‘as close as possible’ is in urgent need of interpretation, if the subsidiarity principle is to have specific normative content. Of course the constitutional norm to allocate political authority in favour of more local levels of governments is in itself not a very operational instruction for the design of constitutional frameworks, and the question of how the general principle is to translate it into more specific constitutional provisions is by no means a trivial issue.

Judgements on the preferability of particular constitutional arrangements (for instance, using the subsidiarity principle in a strict way) over others always refer to somebody to whom these alternatives are claimed to be preferable. In other words, all such judgements are directed to some addressee to whose interests they appeal. In democratic systems the ultimate addressees of constitutional proposals are, of course, the citizens who constitute this union. If the subsidiarity principle is claimed to be a desirable constitutional norm for the European Union, this means that such claims must be supported by arguments that can convince its citizens that it would be in their interest, if efforts in the constitutional construction are guided by this principle. More precisely, these citizens would have to be convinced that adopting this principle would be in their constitutional interest, i.e. the interests that would form their choice, if it were up to them to select the rules for the polity in which they live.

What kind of arguments could one put forward in support of the subsidiarity principle as a constitutional norm? In other words, what kind of arguments could be made in favour of this

principle, when designing a federal European constitution? One major argument for this principle is the central concern on part of the members of any democratic organization about the principal-agent problem, that is the issue of how one can ensure that power delegated to agents can, on the one hand, be used to the benefit of the principals and, on the other, be prevented from being used against the principals' interests. As far as democratic politics is concerned there is a long tradition of inquiry, in political economy as well as in other social sciences, into the advantages of decentralization in political organizations. The results of this inquiry are of direct relevance to the subsidiarity principle.

However, it is obvious that the subsidiarity principle alone neither constitutes a basis to regulate the intergovernmental relations in an enlarged European Union, nor does it protect the collectivities at the grass roots (Feld and Kirchgässner, 1996).¹⁴ Moreover, the authors argue that the introduction of the subsidiarity principle in the Maastricht Treaty has in fact shifted the burden of proof at least somewhat more toward the centralists; the notion of subsidiarity nevertheless remains very general and open to many interpretations. Hence, the use of the subsidiarity principle does not solve the dynamic organizational problem, under which conditions, competencies or 'rights' should be given to lower governmental units. From a Public Choice point of view, there is a need for constitutional rules, which might prevent the 'misuse' of instruments by politicians, bureaucrats, and interest groups. Therefore the subsidiarity principle must be 'filled with life' and the theory of federalism may represent an operational means to regulate the horizontal and vertical relationship between governmental units in the light of a potential Leviathan.

4.2. Fiscal Federalism in a European Constitution

Federalism is an important institution that serves to establish competition within the political arena. Costs rise for the voters as taxpayers if certain groups are able to appropriate the benefits of a publicly supplied good, but do not have to pay the price for it. This group can be the politicians and/or the bureaucrats, who are self-interested rent seekers, or special interest groups, who try to attain their selfish goals. Although it is not argued here that politicians and bureaucrats always maximize their own utility up to the extent of actively exploiting the citizens and taxpayers, politicians and bureaucrats will do it from time to time, if they have

¹⁴ In this context it is not surprising that Delors (1992; p.12) argues that 'subsidiarity does not enact any restriction for the Commission to take political action' and he continues to argue 'solely on the basis of the Maastricht Treaty subsidiarity is not judiciable'. See also Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung (1992), Vaubel (1993, 1995) and Möschel (1993, 1995).

the opportunity. Thus federal competition provides another a 'safeguard' against political decision makers taking unfair advantage of their discretionary power.

Federal competition and federal institutions might also be a very crucial argument in a future European constitution. As has been discussed, the highest federal unit in the European Union should only be given those tasks that bring additional benefits (for instance, due to EU-wide spillovers) to voters/citizens, if they are fulfilled by the highest federal unit, such as foreign defense policy and environmental policy. The restriction of these tasks is necessary so that a more-or-less automatic centralization of tasks (especially in the area of redistribution) at the highest federal level will be avoided. All other tasks should be provided by the EU member states (at what level within the EU member states is not discussed here).¹⁵ The operating principles of a lively federalism can be summarized as follows:¹⁶ as already argued, the European federal government will be constitutionally restricted in its domain of action – severely so. Within its assigned sphere, however, the central government should be strong; sufficiently so to allow it to enforce economic freedom or openness over the whole of the EU territory. The EU member states would be prevented by the federal European authority from placing restrictions on the free flow of persons, resources and goods across their borders.

In order to guarantee, additional to the already suggested constitutional arrangements, that the central power does not take over either fiscal or other items from the EU member states, Buchanan (1995) suggests the exit/secession option in the following way: the EU member states must be constitutionally empowered to secede from the federal European Union. The secession, or the threat there of, represents the only means through which the ultimate powers of the European federal government might be held in balance. In the absence of the secession issue, the federal European government may, by overstepping its constitutionally assigned limits, extract surplus value from the citizenry almost at will, because there would exist no

¹⁵ One could go a step further and put forward the idea of federal competition between and within EU member states when providing goods and services, but also financing them. As has been shown in the extensive research for Switzerland by Kirchgässner and Pommerehne (1995), Pommerehne, Kirchgässner and Feld (1995) there is extensive tax competition in Switzerland, for instance, between the cantons at very small local distances. This tax competition did not result in a breakdown of public good supply in Switzerland and there is no indication of an under-provision of public goods. According to Feld and Kirchgässner (1995; p.8), the income taxes in Switzerland vary quite a lot between the different cantons. Taking the value of the (weighted) average for Switzerland as 100, in 1990 the index of burden in the form of personal income and property taxes ranged from 56.1 in the canton of Zug to 154.1 in Valais. For instance, a family with two children that earns a gross income of CHF 175,000.00 had to pay CHF 16,083.00 in cantonal and local income taxes in Zug, but CHF 34,475.00 in Bern, two cities only about 100 km apart! A critical view of the issue of tax competition is given by Genser (1992) and Sinn (1990).

¹⁶ Compare here the path-breaking study by Brennan and Buchanan (1980).

effective means of escape.¹⁷ With an operative secession threat on the part of the EU member states, the European federal government could be held roughly to its assigned constitutional limits, while the EU member states could be left to compete among themselves in their capacities to meet the demand of citizens for collectively provided goods and services.¹⁸

Considering the arguments about federalism and subsidiarity, which policies should now be allocated at the European federal level? As proposed in part 2 in reference to the jurisdiction of the federal government, the European federal government should be responsible for competition policy defense and environmental policy, all those areas where one can expect EU-wide spillovers, so that the single EU citizen profits from them. The rationale for EU-wide environmental policy is first of all given by the global nature of some of today's environmental problems: for instance, the thinning of the ozone layer and the danger of global warming by increased CO₂ pollution.

5. The Tax Base of the European Government

In Kirchgässner (1994) and Schneider (1993, 1996) it is argued that the activities of the European government should only be financed by proportional (indirect) taxes. The rationale behind this idea lies in the different control possibilities (coming from the Public Choice literature), which exist on different governmental levels.

First, any government will act more in accordance with the preference of the individuals / voters, the more the citizens are able to control it. At the lower governmental levels, with smaller communities, the citizens have better possibilities to force the government to act according to their preferences; hence, this is just another argument to assign government activities to the lowest possible level, again using the subsidiarity principle in a very strict way.

Second, as Feld and Kirchgässner (1995) argue, it implies that tasks as well as financial means that are easier to control are more suited to a higher governmental level than those that are difficult to control. The proposed indirect tax can only be changed by changing a law, which means that any change in the government share has to be decided finding a majority in

¹⁷ Compare here again the pioneering work of Buchanan and Faith (1987) and Buchanan (1991, 1995).

¹⁸ The (threat of) secession should be seen here as an ultimate 'weapon' for every EU member country in order to avoid a development that is not wanted by EU member states and their citizens. In principle it gives the single countries a power over (for them) critical issues and if it is used one might end up in a prisoner's dilemma situation. But as the execution of the secession for a single EU country is not so easy (for instance, a qualified majority of voters in that country is necessary) it is unlikely that this instrument will be used frequently only for tactical reasons. In terms of game theory, the threat is unlikely to be credible.

the parliamentary process and also via referendum, as suggested here. This ensures a public discussion, and at least as long as the European government seeks re-election it will hesitate to increase this tax, and it might face difficulties in getting an approval by the parliament and the voters. Such proportional taxes leave relatively little room for a leviathan behavior of a European federal government, especially if an increase in the tax rate has to be subject to a two-thirds majority of both chambers in the European parliament and the approval of a popular referendum. Therefore, at the European federal level only the revenues from this indirect tax should be available.

6. Institutions of direct democracy in a future European constitution

Beside the important issues of federalism and subsidiarity, institutions of direct democracy like popular initiatives and (obligatory) referenda could also be a crucial factor in a future European constitution. They should be seen as a necessary supplement for the institutions of the representative democracy such as the proposed two chamber system and the European government.¹⁹

There is a second crucial institutional feature, when introducing institutions of direct democracy. Referenda do not simply consist of a choice between given alternatives, but should also be seen as a quite important ‘political education’ process over time. According to Frey (1994) and Frey and Bohnet (1994 a,b) three stages can be differentiated: The first stage is the pre-referendum one, in which the possibility of undertaking a referendum encourages discussion both among citizens and between politicians and voters. Pre-referendum discussion produces a number of important effects. Preferences are articulated, enabling mutually beneficial bargaining and exchange. Moreover, the agenda of alternatives is to a great extent determined by the citizens, thus constituting the relevant decision space. The pre-referendum stage screens the alternatives to be voted upon, reduces the number of relevant alternatives (quite often to only two) and makes the preferences somewhat more homogenous, thereby lowering the chance that the preference aggregation paradox will occur.²⁰ The second stage is the formal decision situation, in which it can be seen that voters clearly express their content or discontent with a proposed referendum and quite often give a government a clear task to do. At the third, the post-referendum stage on the one hand, as just argued, the government has a clear task to do, and on the other hand, quite often, initiators of a referendum force the

¹⁹ Compare Feld (2003), Feld and Kirchgaessner (2000, 2001a, 2001b).

²⁰ Compare Bohnet and Frey (1994 a,b) and Frey (1994).

government to change their policy by only threatening to bring an issue into a popular referendum. But in some cases the government can also undertake unpopular measures (like tax increases), if they are supported in a popular referendum.²¹

The institutions of direct democracies also have other important means, such as their possible use by the voters to break politicians' cartels directed against them. As Frey and Bohnet (1994) proposed, rent seeking theory argues that representatives have a common interest in forming a cartel to protect and possibly extend political rents.²² Referenda and initiatives can be means to break the politicians' coalition against voters. Initiatives require a certain number of signatures and if the initiators obtain these signatures they can force the government to undertake a referendum on a given (mostly disputed) issue. They are a particularly important institution, because they take the agenda setting monopoly away from the politicians and enable outsiders to propose issues for democratic decision, including those that many elected officials might have preferred to exclude from the agenda. As has been demonstrated in public choice theory the group determining which propositions are voted on, and in what order, has a considerable advantage, because it decides to a large extent the issues that will be discussed when and which ones will be left out.²³ Referenda, whether obligatory or optional, enable the voters to state their preferences to the politicians more effectively than in a representative democracy. In a representative system, deviating preferences with respect to specific issues can only be expressed by informal protests, which are difficult to organize and to make politically relevant.

If one summarizes these findings, one can draw two conclusions: Cumulating research on the properties of a popular referendum has revealed two major aspects on which institutional economics has to focus. One is the importance of discussion in the pre-referendum state (Frey, 1994). This implies that the number of propositions and the frequency of ballots must be low enough that the voters have an incentive and the opportunity to collect and digest the respective information in order to participate actively in the decision.

The second element is that direct democratic institutions enable voters to break politicians' and parties' coalitions directed against them. Direct participation serves to keep the ultimate

²¹ For instance, a referendum might help the government to undertake unpopular measures in environment policy, compare Frey and Schneider (1997).

²² The literature on rent seeking was developed by Tullock (1967) and one of the latest surveys is by Tollison (1982).

²³ Compare Denzau (1995) and Mueller (1987, 1989).

agenda-setting power with the voters. Initiatives and referenda are effective means by which the voters might regain some control over the politicians.

Hence, introduction of direct democratic institutions like the referendum at the highest European federal level in European constitution is an absolute necessity, especially if the European federal government wants to change the tax structure or wants to take over new a policy field.²⁴ This can only be implemented if it is approved by the legislation of the two chambers and by a popular referendum and if it is approved by a majority of the states. Hence, the introduction of direct democratic elements would be crucial for a future European constitution so that the European government keeps strictly to its given tasks.

The introduction of direct democratic elements in a future European Constitution is supported by various other researchers, like Feld (2003), Feld and Kirchgaessner (2003), Blankart and Mueller (2003). Especially, the introduction of direct democratic elements can be an excellent tool in order to create an European identity. If European voters have a “say” (e.g. to decide about European Union matters) they will be better informed about European affairs, they discuss it, they learn about it and after sometime they will decide in an European way, and not only in a way, is it good for Italy, Germany or France. Therefore, especially the element of a direct democracy is a very important “tool” to “create” an European identity.

7. Conclusions

In this paper an attempt has been made to provide some basic elements of a future European federal constitution in order to provide the necessary and functioning framework for a functioning the European Union with now 25 members. Six basic elements have been put forward, like that the European Commission should be turned into the European government, the Council of Ministers into a second chamber, and that the European Parliament should get full control and responsibility over all federal items together with the chamber. The jurisdiction of the European federal government should consist of a few specific items which are best suited for the highest federal level, like foreign defense and environmental policy. The activities of the federal European government should be financed by one proportional (indirect) tax, and direct democratic institutions should be introduced in a European federal constitution, like the possibility to force the European government to set up a referendum. These elements are then justified by arguments dealing with the subsidiarity principle, the

idea of federalism, and with the effects of direct democratic institutions. As has been demonstrated, these elements are best suited to limit the domain of central European authority in the long run, even in the face of a strong tendency to centralization in nearly all federal states that has been observed during recent decades.

The idea is also proposed that the constitution should be structured in such a way that any attempt of a future concentration of government activities at the European federal level will be prevented by explicitly assigning specific governmental functions to each level of government and to put in additional safeguards, like the subsidiarity principle and the direct democratic institutions, so that the federal European government cannot take over tasks which are not approved by the majority of voters and European member states. From another perspective it is also very difficult for the European government to take over additional tasks, because the necessary widening of the tax base can only be done if a majority of European voters / taxpayers approve it and also a majority of the member states. Neither can the European government accumulate large deficits, which might hold as another safeguard to limit the domain of a future central authority in Europe.

Two central features—direct democracy and fiscal federalism—should be key principles in a future European constitution, which have shown in other federal units (like Switzerland and the United States) that they are strong safeguards against policies that are not in line with a majority of voters' preferences. Moreover, direct democratic elements provide the possibility for European citizens in a federal state to participate actively in political decision making, to break politicians' and interest groups' cartels and prevent a shifting of responsibilities from EU member state levels to the EU federal government level. A proper assignment of the tax competencies may also help to restrain centralization. If, as suggested here, that the tax competencies lie within the EU member states—with the expectation of one specific indirect tax for the European government—such an element should also work.

With respect to the actual crisis of the European Union in 2005, which resulted in a rejection of the proposed European constitution the French and Dutch voters and other countries might follow, much more simple and much less ambitious constitutional items (for instance, the introduction of a two chamber system, both chambers being fully responsible for all federal items, and the possibility of a referendum) could help to overcome the fears of the majority of European citizens. Since, according to Downs (1957), rational voters are rational

²⁴ Such a conclusion is also reached by Bernholz (1990b), Feld and Kirchgaessner (1996) and Vaubel (1993 and 1995).

ignorants, it is necessary to build the European Union in a way that beside the advantage of the monetary union some additional ones can be perceived by the ordinary citizens as well, even if they are not well informed. Up to now, however, the advantages of the European Union are very indirect and often not at all obvious for the citizens, while the public discussion focuses on the interests of producer interest groups and the influence of Brussels bureaucracy. Thus, today the political opinion of ordinary citizens about the European Union varies between apathy and refusal. If such a simple and constitutional perspective could be provided, which is understood and accepted by the majority of the European citizens, then the actual political crisis can be overcome. However, this is a long way and needs a quite drastic political change. European member state governments and the EU political actors have to take much more serious on the European issues (unemployment, (illegal) immigration, etc.), which are of great concern for the European voters, and have to convince their voters that they are able to solve these problems with the help of a minimal European Constitution.

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