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The Boundaries of the State

Michael Wohlgemuth

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The Boundaries of the State

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1. Introduction: boundaries, limits and borders
2. Humboldt's „Boundaries of the State"
   2.1 Against the welfare state
   2.2 Against state education, state religion and moral reform politics
   2.3 Humboldt's minimal state
3. Are small nations more likely to be minimal states?
   3.1 Befits and costs of nation size
   3.2 What would Humboldt say (today)?
4. The evolutionary merits of "varieties of situations": institutional competition
5. The European Union: too big and too small
   5.1 Club-theoretical intuitions
   5.2 Deeper or wider Union?
   5.3 Flexible voluntary integration
6. Conclusion

1. Introduction: boundaries, limits and borders

"*Die Grenzen des Staates*" – the Boundaries of the State – is the (abbreviated) title of one of the boldest classical liberal texts a German (then: Prussian) has ever written. Wilhelm von Humboldt (1767-1835) whom Hayek (1960, p.434) called Germany's "greatest philosopher of freedom" completed most of this essay early in 1791; but the whole text could only be published posthumously in 1851 by the author`s younger brother Alexander, the eminent naturalist and explorer. A first English translation appeared soon in 1854 under the title "The Sphere and Duties of Government".[1] It had a substantial influence on John Stuart Mill's famous essay "On Liberty" (1859)[2].

The German word "*Grenze*" has an intriguing variety of meanings: it means boundary, but also limit(ation), frontier, and border (control). "*Die Grenzen des Staates*" might thus allude to boundaries/limits of state activity, but also to boundaries/borders/frontiers of a jurisdiction's territory. In this paper I want to look at the "boundaries of the state" in both dimensions: the size of government and the size of nations. Is Humboldt's radical idea of a "minimal state" more likely to be realized in an organization subjecting a small number of citizens/inhabitants under one rule of (one) law, or in a large state, or in a Union of (smaller) states?

Historians and economists give no definite answer. Historical, empirical and theoretical findings do offer manifold confirmations of Tocqueville's (1835/1968, p.196) famous claim that "small nations have been the cradle of political liberty". However, there is no uncontested simple rule such as "small is beautiful" (or: classical liberal). Mainstream theories and observations offer only context-dependent trade-offs that change with many variables such as market conditions (e.g. size of and access to markets), political and economic transaction costs, production and communication possibilities, or industrial, agricultural and military technologies, to name just a few[3]. Even a historian would reach her limits if she were to present and discuss in one paper all these elements for many periods in many regions of the world. In this paper I therefore limit myself to the already rather ambitious task of looking at some interrelations between limits (of government activity) and borders (of nation size) as they present themselves in the Europe of today.

The paper is organized as follows: in part 2, I give a short account of Humboldt's "boundaries of the state" that relates to many present-day challenges to classical liberalism: his blunt rejection of any "solicitude of the state for the positive welfare of the citizen" which also covers education, religion and any kind of moral paternalism. In part 3, I refer to the new economic literature on the "optimal size and number of nations" in order to discuss whether small states are more likely to be (nearly) minimal states. This literature tends to disregard Humboldt's arguments in favour of exposing the individual to "varieties of situations" that he can choose and from which he can learn to "self-develop". Therefore, in part 4, I argue that the evolutionary merits of this exposure can be illustrated by regarding institutional competition as a Hayekian "discovery procedure". In part 5, I look at the partial removal of borders within the European Union and, using some intuitions from club theory, I argue that,

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[1] Coulthard's translation (1854/1996) is a still available reprint. A facsimile of the German first edition is available at http://files.libertyfund.org/files/2318/Humboldt_Ideen1549_Bk.pdf. The full German title is: "*Ideen zu einem Versuch, die Grenzen der Wirksamkeit des Staats zu bestimmen*" which one could translate as "ideas concerning an attempt to determine the limits of the effectiveness of the state".

[2] In his Autobiography Mill writes: "the only author who had preceded me … of whom I thought it appropriate to say anything, was Humboldt" (c.f in: Miniter 1991). The similarities are striking indeed; however, as Doering (2004, p.15) observes, "Mill interpreted Humboldt within his own utilitarian framework … He did not embrace the more metaphysical aspects of Humboldt's neo-humanstic teleology".

[3] See, e.g. Kohr (1957/78), Jones (1981) North (1981, 1998), Rosenberg/Birdzell (1986), Mokyr (1990), Volckart (2000) who mostly argue that decentralization of power and competition amongst various jurisdictions has contributed to the rise of "Western" liberty, ingenuity, and (as a consequence) wealth.

in terms of the size of European government, integration has become in most areas "too deep" whereas in terms of the size of membership in the Union the EU has grown "too big" in some areas and "too small" in others. I conclude with a plea for more decentralization and competition amongst jurisdictions as a way to lead, "as if by an invisible hand", to at least somewhat more limited states. My qualified claim is thus: more, and more open, boundaries between states lead to more limited governments.

2. Humboldt's "boundaries to the state"

For Humboldt (p.2)[4], political constitutions have "two grand objects ... first, to determine who shall govern, who shall be governed, and to arrange the actual working of the constitutional power; and secondly, to prescribe the exact sphere to which the government ... should extend or confine its operations". The "true, ultimate purpose" not only of his essay but also of a classical liberal constitution is the latter object, since it "more especially determines the limits of [the citizen's] free, spontaneous activity" (ibid.). I think that Humboldt's idealistic individualism would easily embrace Lord Acton's famous dictum that "It is bad to be oppressed by a minority, but it is worse to be oppressed by a majority" (1877/1985, p.13).

This is Humboldt's normative, individualistic, benchmark: "The true end of Man ... is the highest and most harmonious development of his powers to a complete and consistent whole" (the very citation is the motto of Mills' "On Liberty"). And for this development freedom is "the grand and indispensible condition" – together with "a variety of situations" ("*Mannigfaltigkeit der Situationen*" – which might be translated as "manifoldedness") which enable individuals to enter freely into voluntary cooperation and association with equally free others (p.11)[5]. Freedom and variety – both ideals are dominant and ever present when Humboldt attempts to determine the limits of the state. They shall also be dominant when this essay develops.

2.1 Against the Welfare State

Humboldt (p.19) distinguishes two ends of the State: "either to promote happiness or simply to prevent evil"; it can aim at "Positive Welfare" or "merely at security". The latter is later discussed as the protection of individual rights by ways of the Rule of Law. The former may be "manifested directly in such institutions as poor laws, or indirectly, in the encouragement of agriculture, industry, and commerce, of all regulations relative to finance and currency, imports and exports etc. (insofar as these have this positive welfare in view)" (p.21)[6]. I would expect that almost all these former policies were then (and certainly today) regarded beneficial attributes of a modern state. Not so for Humboldt: "Now all such institutions, I maintain, are positively hurtful in their consequences, and wholly irreconcilable with a true system of polity". Humboldt offers several closely related reasons:

a) "however wise and salutary" the effort of the state to "elevate the positive welfare of the nation" may be, "it invariably superinduces national uniformity, and a constrained and

[4] If not otherwise indicated, all pages refer to Humboldt (1854/1996).

[5] Humboldt states in a rather Kantian way: „that reason cannot desire for man any other condition than that in which each individual not only enjoys the most absolute freedom of developing himself by his own energies, in his perfect individuality, but in which external nature even is left unfashioned by any human agency, but only receives the impress given to it by any individual of himself and his own free will … restricted only by the limits of his powers and his rights".

[6] S.a. p.45: „the means by which freedom is limited with a view to welfare are very various in their character, as laws, exhortations, premiums, … immunities, monopolies, etc. and the power acquired by the sovereign as chief landowner".

unnatural manner of action" (p.21). Again, Humboldt's ideal is "the free development of character in all its vigorous and multiform diversity of phase and manifestation".

b) "these positive institutions tend to weaken the power and resources of the nation", because the "man who frequently submits the conduct of his actions to foreign guidance ... can more easily ascribe his shortcomings to his peculiar position, and leave them to the responsibility of those who have shaped it for him", thus "his notions of right and wrong, of praise and blame, become confounded" (p.23, 25).
c) Also, welfare crowds out charity on the supply-side, as Humboldt observes: the fellow-citizen "learns to abandon to [the State's] responsibility the fate and well-being of his fellow-citizens"; this tends to "deaden the living force of sympathy and to render the natural impulse to mutual assistance inactive" (p.26).
d) Finally, the welfare state "cannot meet individual cases" (p.35), instead it establishes a growing bureaucracy which "requires an incredible number of persons to devote their time to its supervision, in order that it may not fall into utter confusion" (p.33). Supervision, in turn "necessitates new forms, new complications, and often new restrictions, and thereby creates new departments, which require for their supervision a vast increase of functionaries" (p.39f).

In short: in order for the citizen to fully develop her "positive freedom" ("self-development") in confrontation with a "variety of situations", the state must be restricted to only guaranteeing "negative freedom".

2.2 Against state education, state religion, and moral reform politics

Again, freedom and diversity are the decisive arguments that lead Humboldt to hold that "national education ... organized or enforced by the State ... is at least in many respects very questionable" (p.65). The key word is "*Bildung*" which is only insufficiently translated as "education". It refers to Goethe's and Schiller's views of aesthetics and means the cultivation and formation of one's own personality in a way that defies any utilitarian purposes imposed from outside the individual himself (Doering 2004, p.13). "*Bildung*" may be viewed as an amalgam of "self-education", "self-realization" and "self-cultivation" (Mueller-Vollmer 2011, p.15). Again, human development and "*Bildung*" depend on the "self's" exposure to and discovery of the "richest diversity" ("*Mannigfaltigkeit*"). State education, however, "must always promote a definite form of development" and thus "repress those vital energies of the nation" (p.65, 67)[7]. Consequently, "national education seems for me to lie wholly beyond the limits within which political agency should properly be confined" (p.71).

There is some irony of history that one of the largest state-run German universities is named after Wilhelm (and Alexander) von Humboldt who was Prussian minister of Public Instruction from 1809 to 1810 and indeed spent most of his career serving the Prussian government. One explanation is that Humboldt was after all a reformer and not a revolutionary (Doering 2004). Also, he mostly served during the short-lived Prussian reform era after the Napoleonic wars when von Stein and von Hardenberg introduced decentralized self-administration in Prussia; and Humboldt aimed at doing the same for schools and universities[8]. In 1819, Humboldt drafted a plan for a liberal constitutional monarchy in the

[7] Humboldt's argument for private (market) education is based also on supply-side incentives: "tutors better befit themselves, when their fortunes depend upon their own efforts, than when their chances of promotion rest on what they are led to expect from the State. There would, therefore, be no want of careful family training, nor of those common educational establishments which are so useful and indispensible." (p.69f).

[8] Humboldt introduced a multi-tiered system of elementary school, Gymnasium and university open to all talents irrespective of rank or status. He advocated the abolishment of military schools and the closing of schools for nobility; and home schooling (which he enjoyed himself also in economics, natural law and philosophy)

wake of the reactionary anti-liberal "Karlsberg Decrees". King Friedrich Wilhelm III immediately dismissed him from all his duties on New Years Eve of the same year (Mueller-Vollmer 2001, p.9).

When discussing "religion" and "moral reform" in two longer chapters, Humboldt attacks much of what in today's language would be called "merit goods" to be provided or at least subsidized by the state. He does not ignore that religion and morals form a "cement of society" (Elster 1989). But he is convinced that any state privilege for any religion or any state programme for moral education will do more harm than good. For Humboldt, the "simple idea of moral perfection is great, and inspiring, and exalted enough to require no other veil or form" (p.78). A religious belief in "a Being who is at once the source of all truth, and the sum of all perfection" can be helpful in gaining "greater certainty and consistency" (p.77) in our quest for moral perfection, but it is not "necessarily connected to it" (p.80). For politics, this implies that "all which concerns religion lies beyond the sphere of the State activity" (p.96). The state can support "self-development" of individuals only "by removing obstacles that prevent the citizen's mind from becoming familiarized with religious ideas, and by promoting a spirit of free inquiry". If the legislator "ventures to direct or diffuse a spirit of religiousness; if he shelters or encourages certain definite religious ideas; or if, lastly, he dares to require a belief according to authority in lieu of a true and sincere conviction", he will destroy liberty, diversity and "most effectively thwart or deaden the soul's noblest inspirations" (p.86).

The very same reasons oblige Humboldt's minimal state to abstain from all forms of "moral reform" or "any attempt to operate directly or indirectly on the morals and character of the nation" (p.113). Humboldt not only refers to "the fact that coercion and guidance can never succeed in producing virtue"; it also "engenders all selfish desires, and all mean artifices of weakness" (p.111). The result would be a paternalistic state and society which may be "tranquil, peaceable, prosperous" – but would "seem to me a multitude of well cared-for slaves, rather than a nation of free and independent men, with no restraint save such as was required to prevent any infringements of rights" (p.110).

2.3 Humboldt's minimal state

What remains as the only obligation of the state is described by Humboldt in very much the same vein in which James Buchanan (1975) describes the role of the "protective state": a state limited to the provision of security which Humboldt called "negative welfare" or Hayek (1960. p.19) would call the "negative" values of a free society: liberty, peace and security. Humboldt's argument (p.51ff), in modern language, runs as follows: in a state of nature, individuals engage in wasteful conflict, armament, conflict-avoidance and revenge. Thus they are kept from engaging in more productive efforts and from reaping mutual gains from trade. Only a third party such as the state has a comparative advantage in the use of violence and can help freeing individuals from a Prisoners' Dilemma[9]. However, this logic applies (only) to

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remained possible. By strictly limiting the King's influence on education, Humboldt fostered autonomy and decentralization of schools and universities.

[9] As the reader might be thinking that I am interpreting too much into Humboldt, here are his own words: "Now, without security, it is impossible for man either to develope his powers, or to enjoy the fruits of his exertion … this is a situation which man is wholly unable to realize by his own individual efforts … Wrong begets revenge; and revenge is but a new wrong. And hence it becomes necessary to look for some species of revenge which does not admit of any other retaliation – that is the punishment inflicted by the State, or for a settlement of the controversy which obliges the parties to rest satisfied, viz. the decision of the judge ... our States are in a far more favourable position than we can conceive that of man in a state of nature to be … that the maintenance of security, as well with regard to the attacks of foreign enemies as to the danger of internal discord, constitutes the true end of the States" (p.52f).

matters of securing individual (property) rights, conflict settlement and defence against foreign aggressors[10].

It must be noted that Humboldt takes much care to narrowly define "security" and "protection" in the second half of his book since these concepts can also be used by adherents of "positive welfare" ("social security") or state intervention ("police state") to reduce freedom beyond any limits of state activity. "Without some distinct definition, it is impossible to re-adjust those limits and repair that confusion" (p.115). Humboldt defines security as "the assurance of legal freedom" which means that citizens are "secure, when, living together in the full enjoyment of their rights of person and property, they are out of the reach of any external disturbance from encroachments of others" (p.116f). It is only "actual violations of right" which require the state to act – but not results of spontaneous activities (say, on the market) as may be judged "based on the shifting grounds of utility" (p.117)[11]. Welfare statists, welfare economists, even "libertarian" paternalists and conservative moralists are not based on Humboldt's grounds[12]!

3. Are small nations more likely to be minimal states?

In 1791, when Humboldt wrote his essay on the "boundaries of the state", there were many borders within what only 80 years later would become the German nation or empire. One could count some 300 kingdoms, principalities, city-states or church-owned territories. Some of Humboldt's contemporaries and today's economic historians (e.g. Volckart 2002, Vaubel 2005) claim that the availability of many alternative jurisdictions nearby have greatly contributed to the advancement of personal liberties, especially for artists and academics, but also for merchants, traders and craftsmen. We will come back to this aspect of Humboldt's praised availability of "varieties of situations and circumstances" in the next part.

In his "boundaries of the state" Humboldt does only occasionally discuss the size of nations. But the general thrust of his argument is clearly in favour of small states governed upon the consent of citizens[13]. In an argument that anticipates much of what Hayek (1939/80)

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[10] Humboldt (p.55ff) does not condemn war as such; he quite idealistically sees in it an occasion in which individual "endurance and fortitude are steeled and tested" and freedom defended. For the same reason he "argues against the maintenance of standing armies" which condemn "in time of peace a considerable portion of the nation to this machine-like existence".

[11] Here again one can feel Kant's influence. Compare Kant's famous dictum that "Welfare … has no principle, neither for him who receives it, nor for him who distributes it (one will place it here and another there); because it depends on the material content of the will, which is dependent upon particular facts and therefore incapable of a general rule" (Kant 1798, section 2, para.6).

[12] Again, some quotes to substantiate my claim: "it is not enough to justify such restrictions, that an action should imply damage to another person; it must, at the same time, encroach his rights". This seems also to qualify John Stuart Mill's "harm principle" when he (1859) discusses the issue of paternalism (see Wohlgemuth 2010 or Hayek 1960, p.145 on this issue). Humboldt (p.124) insists: "The State, then, is not to concern itself in any way with the positive welfare of its citizens, and hence, no more with their life or health, except where these are imperilled by the actions of others" – and: in an "unrightful" way (p.124). Thus: "he who utters or performs anything calculated to wound the conscience and moral sense of others, may indeed act immoraly; but … he violates no right. The others are free to cut off all intercourse with such a person, and, should circumstances render this impossible, they must submit to the unavoidable inconvenience of associating with men of uncongenial character, not forgetting, moreover, that the obnoxious party may likewise be annoyed by the display of peculiar traits in them." (p.121f). In this vein, Humboldt also argues for civil laws to allow for divorce without "extenuating reasons" (p.135), the legalization of suicide and "even the taking of a man's life with his own consent" (p.154)

[13] When the question of a unified Germany was more and more on the agenda (also for German classical liberals), Humboldt (1813/1968) published a "Memorandum on the German Constitution" in which he advocated a decentralised confederation (instead of a consolidated federal government) arguing that cultural and political diversity should by no means be reduced, since "Such diversity alone is not only harmless, but is necessary in order to reconnect the constitution of each *land* (state) strictly with the peculiarity of its national character" (c.f.

and Buchanan/Tullock (1962) have developed much later, Humboldt (p.48f) argues that (a) consent of all citizens is a necessary element of a just constitution, (b) consent would preclude a welfare state that went beyond a mere protective "minimal state" and that can only be upheld by ways of a majority vote system, (c) "exit" remains the only alternative for non-consenting citizens, and (d) the larger the state (both in terms of citizens and "solicitudes") the less likely can it be beneficial and consensual[14].

Are small nations more likely to be minimal states? Many classical liberal authors thought so[15]. But, as already indicated in the introduction, there is no unqualified simple answer to the question. Throughout history, the number and size of nations has varied substantially as a reaction to many endogenous and exogenous factors. Recently, the number of independent states has multiplied (from 76 in 1946 to about 193 in 2003, Alesina 2003, p.302[16]). Some states are as large as China or India, some as small as Liechtenstein or Tuvalu. In terms of GDP per capita, amongst the five largest countries only the USA is "rich" in terms of per capita income. Really small countries such as Luxembourg or Liechtenstein are the richest in the world. Also the ranking of "Economic Freedom of the world" (Fraser Institute 2010) is lead by relatively small countries such as Hong Kong, Singapore, New Zealand, Switzerland and Chile[17].

3.1. Benefits and costs of nation size

Meanwhile, a large number of economic theories and econometric studies have been undertaken to determine an "optimal" size (and number) of nations and confront this with the actual sizes and numbers. Today's literature, initiated by David Friedman (1977), is mostly inspired by works of Alberto Alesina and Enrico Spolaore[18]. I cannot here give a full summary and interpretation of this enormous literature. But the general idea is simple (and thus lends itself to neoclassical equilibrium modelling): "Borders are a man-made institution" (Alesina 2003, p.301). And: borders define the costs and benefits of a nation's size[19]. As a

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in Doering 2004, p.16). The basic motives for German liberals to support patriotic unionists were (a) to establish a common market or free trade zone ("Zollverein") and to provide external security against Napoleonic France.

[14] Here is the argument in Humboldt's own words: „the point to which the whole argument conducts us, is the necessity of securing the consent of every individual. But this very necessity renders the decision by a majority of voices impossible; and yet no other could be imagined in a State union which, to regard single objects, extended its activity to the positive welfare of the citizen. Nothing would be left to the non-consenting but to withdraw themselves from the community in order to escape its jurisdiction, and prevent the further application of a majority of suffrages to their individual cases … it is … certain that every larger association is in general less beneficial … In large associations [man] is too prone to become an instrument merely".

[15] I have already mentioned de Tocqueville (1835/1968). Spolaore (2005, p.1) found quotes in Plato's "Laws" that 5.040 heads of family were the optimal size of a "state"; and that in Aristotle's "Politics" populous states in which people no longer know each other cannot be "run by good laws". Here, of course, the organization of a small group is the measuring rod and not the universalizable laws governing a spontaneous order or "open society (Wohlgemuth/Sideras 2004). Still, a modern Tocquevillian version of decentralization combined with openness can be found in Röpke (e.g. 1959, part 3).

[16] Most of the increase is, of course, due to the evaporation of the Soviet empire The recent (mostly peaceful) changes of the European political map is quite unprecedented, as Lübbe (2007) argues, who counts that from 1918 until today, the number of sovereign states increased more than 7fold in Eastern Europe (including the old Osman Empire).

[17] These are the top five, followed, however, by the United States, Canada, Australia – and Mauritius.

[18] Their classical journal contribution is Alesina/Spolaore (1997); a reader-friendly book-length publication of their ideas is Alesina/Spolaore (2003).

[19] It is quite stunning to see how almost all criteria for costs and benefits of the size of nation can already be found in Tocqueville's famous chapter VIII, part V on the "Advantages of the Federal System in General and its Special Utility in America".

consequences, borders can be "optimized" – in theory ("chosen by a hypothetical social planner maximizing a social welfare function", Alesina 2003, p.305).

On the benefit side of larger nations are economies of scale in the production of public goods, the possibility to internalize externalities within the nation and the availability of a larger market. Larger states imply lower per capita costs (economies of scale) in areas such as "general-policy coordination and administration, defense and foreign policy, a legal and judicial system, police and crime prevention, a monetary and financial system, infrastructure for communication, public health, and so on" (Spolaore 2005, p.4). Cross-regional externalities or "shocks" (environmental, or "social") can also be better "internalized" (via regulation and redistribution) within one nation (Alesina/Spolaore 2003, ch. 10). And: "larger nations mean larger domestic markets when political borders are associated with barriers to international exchange" (Spolaore 2005, p.4).

On the cost side of larger nations, only one category is seriously been taken into account: that "larger populations are associated with higher heterogeneity of preferences of different individuals. Being part of the same community implies sharing jointly-supplied public goods and policies in ways that cannot satisfy everybody's preferences".[20] The extreme case is that nations extend so far as to be forced to accommodate "ethno-linguistic fractionalism which is shown to be inversely related to measures of economic performance, economic freedom, and quality of government" (Spolaore 2005, p.5).

3.2 What would Humboldt say (today)?

If Humboldt were to look at the theoretical and empirical findings of the Alesina school, he might, at first, be puzzled. If his sole "solicitude" of the state – the provision of security against infringements of the negative liberty of citizens and against foreign intruders – is such a classical "public good" it should be more "efficiently" be provided by large nation states ("larger countries can provide better and cheaper security for their citizens", Spolare 2005, p.17). At the same time, Humboldt might be appalled by the additional amount of "public" (or "meritory") goods relating to "positive welfare" which large bureaucracies could also provide at lower costs per tax-payer. And finally, he might ponder on why "diversity" shows up solely on the cost-side of the optimization equation and not as a benefit to the citizen exposed to "self-education" within a realm of freedom and a "variety of situations".

I cannot go here more into contrasting an alleged reaction of Humboldt with the equilibrium models of the Alesina school. A closer look at the simplifying assumptions underlying their hypothesis that "through a democratic process, more countries are created than with a social planner who maximizes world average utility" (Alesina/Spolaore 1997, p.1028) might make him frown[21]. The hypothesis that autocratic, "Leviathan" states tend to be

[20] Indeed, what is often called "public good" can be a "bad" for some. A public health system, a standing army or a state-sponsored religion may show technical attributes of "non-excludability" and "non-rivalrous consumption"; however for a Humboldtian liberal, they would be "hurtful in their consequences" – the consequences of not being able to "exlude onself" from having to "consume" (and pay for) services that the liberal would reject.

[21] These assumptions rely on a model with given preferences, perfect information of voters and politicians, the median voter dictating policies, no "exit" of mobile resources, and many other exogenous variables that make optimization manageable. Especially the costs of "diversity" are determined based on a simple Hotelling-Downs model of distance from a given median position. For a rather radical critique of this model's ability to grasp political competition in a democracy, see Wohlgemuth (2005). Friedman (2005) argues that the Alesina et. al hypothesis (democracies produce too many, too small states) is "an artifact" of the assumption of linearity of "distance". If distance (diversity, or heterogeneity) were assumed to produce more than linear costs, the hypothesis would already be reversed. Hermann-Pillath (2009) offers many reasons why "there is no direct impact of diversity on the costs of government" (p.35). One is that, based on the logic of "rational ignorance" of voters (Downs 1957) and "preference falsification" (Kuran 1995), larger nations might indeed "converge toward

and remain "too big" (at least in terms of population subjected to uniform expropriation of rents, s. Alesina 2003, p.306) should not surprise him[22]. However, he would probably endorse the view, also supported by the calculus of Alesina et. al., that smaller states (both in terms of number of citizens and of "solicitudes") tend to benefit from and support present trends towards free trade, openness and peace – the very pillars of the "negative welfare" that define the "boundaries of the state" and give citizens the possibilities to "self-develop".

It is here that the neoclassical mechanistic calculus coincides with classical-liberal, Humboldtian idealistic gut-feeling about the proper size and scope of nations and governments: Historically, "absolutist regimes needed 'size' to support wars and an inward looking economy … wars made states" (Alesina 2003, p.310). At the same time, peace and trade made freedom and wealth possible – both historically – e.g. in small states such as Italian cities during Renaissance, or between members of the Hanseatic League (Dollinger 1977), but also in small states (such as Luxembourg, Liechtenstein, Switzerland, or Singapore) today: "With peace, democracy, and free trade small and relatively homogenous communities can enjoy independence and prosperity" (ibid., p.312). As a consequence, "small countries have an interest in maintaining free trade" (Spolaore 2005, p.16)[23].

Under these very conditions (which seem much more prevalent today than during the last decades), nation states may indeed have become "too large" and a settlement of peaceful "secession" (or milder forms of granting more local autonomy) no longer poses a threat neither to the old nor to the newly forming nations. Communities can now more easily opt out of their allegiances that formerly tied them to overly large (both: protective and welfare) states and opt in to the globalized market (under the rules of the WTO, or NAFTA, or the EU) and have their security concerns covered by membership with NATO[24]. With increasing economic integration, secession becomes less costly and more beneficial, as the break-up of the Soviet Union has shown and regional separatism in Spain, Belgium, or the UK might show in the future[25].

In part 5, I try to show that, within the EU as it is today, opting out of (parts) and opting in (parts) of the European Union still meets with tremendous obstacles. As a most complex and far-reaching "multi-purpose club", the EU mostly adheres to an "all-or-nothing" and "one-size-fits-all" ideology of membership that is able to frustrate both mutually beneficial secession and flexible (partial) accession. Before I turn to these intricacies of the political economy of European integration, let me shortly return to Humboldt's dominant theme of (negative) freedom and "*Mannigfaltigkeit"* that both contributed to the formation ("*Bildung*") of the "European miracle" (Jones 1981). Freedom (of choice) and variety ("of situations") have one common denominator, both as a prerequisite and as a consequence: competition.

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a common state of rational ignorance" and a state of large-scale, path-dependent, misrepresentation of one's true preferences. Hermann-Pillath has done much research into Chinese culture …

[22] The "Leviathan" model assumes rent-maximization of monopolists who only need support of a strategic minority of the population.

[23] Röpke (1959, p.170) observes that citizens of small and industrialized nations "follow far less than the inhabitants of large states the temptations of economic irrationality, propaganda for autarky, exchange-control or devaluation"; also "cartels … can here pursue their harmful practices only within certain limits"; therefore small states are "today particularly indispensable supports of the world economy" (p.171).

[24] It is no surprise that in Switzerland's direct democracy adherents of abolishing the army gain ground since there is no threatening cavalry in sight, whereas the Chinese government seems to invest more (in absolute terms) in military spending (which might be a better long-term investment than buying US treasury bonds). Of course, the question of free-riding on other's tax-payers money spent on providing a (near) global public good does arise.

[25] The threat of Secession places an upper limit on democratic states' power to tax, as Buchanan/Faith (1987) have shown. Both Secession (and unification) can support (classical-liberal) reform, as Yarbrough/Yarbrough (1998) have argued (also with interesting reference to the Czech-Slovak secession.

4. The evolutionary merits of "varieties of situations": institutional competition

The work of the Alesina school on the (optimal) "size of nations" is rich in insights. But its welfare economic optimization approach ignores important aspects that only an evolutionary view of politics (and markets) can unveil. Alesina et. al. mostly look at an optimization calculus of one nation in isolation ("we assume that individuals are not mobile", Alesina/Spolaore 1997, p.1031). But with smaller nations and freer trade there should be a higher "degree to which nations must compete for citizens and capital" (Friedman 2005).

In short: there should be institutional competition which, by qualifying the state's monopoly of power, should be able to further limit state activities – and, by providing a discovery procedure and learning process, inter-jurisdictional competition can support political "*Bildung*", the formation (and more likely realization) of political preferences.

Humboldt (p.45), after having discarded any solicitude of the state for "positive welfare", asks: "Should it be objected to these assertions that it appears somewhat strange to deny the State a privilege which is accorded to every individual, viz. to propose rewards, to extend loans, to be a land-owner"? No, he writes, since the state differs in one crucial respect: its monopoly of power. By contrast, "the influence of a private person is liable to diminution and decay, from competition, dissipation of fortune, nay even death; ... clearly none of these contingencies can be applied to the State".

However, no state can rid itself completely from the contingencies of competition with likewise powerful rivals: other states that offer more attractive conditions for owners of mobile resources. Institutional competition amongst many (thus: preferably small states) has often been praised by classical liberals and found by (economic) historians as a way to limit the powers of the state.[26]

I have already pointed out that openness and peacefulness are conditions that tend at the same time to favour small states (both in terms of size and scope) and to be favoured and fostered by these small states. With openness comes competition, the option of "exit" for owners of mobile resources. This very option tends to "tame Leviathan", viz. to set limits to its powers to tax and to enforce "positive welfare" interventions on its people. The very logic can be framed in terms of Mancur Olson's (1993) model of the state as "bandit": Expropriation and violence is worst with citizens exposed to mobile, "roving bandits". "Stationary bandits" or autocratic states (having a longer time-horizon) are taking less life, liberty and money than roving bandits, but they would still try to enrich themselves as much as they can, based on their monopoly of coercion and taxation. Democratic states (having to please a majority of voters) are, according to Olson, further limited in their rational self-interest to expropriate their citizens. Competition between states creates even further limits on the states' ability to coerce and tax: with stationary bandits (democratic or autocratic), but mobile citizens, the self-interested calculus of governments is exposed to even more limiting factors.

I take it that the case for inter-jurisdictional (especially: tax) competition as a limiting factor on the states's power is rather well established and in no need for further explanation.[27]

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[26] See Vaubel (2008) for a comprehensive survey of the history of ideas with references e.g. to David Hume, Adam Smith, Adam Ferguson, Lord Acton, Montesquieu, Turgot, de Tocqueville, Immanuel Kant, Wilhelm von Humboldt, and the modern literature including Geoffrey Brennan, James Buchanan, Friedrich von Hayek, and economic historians already mentioned in footnote 2.

[27] See Feld/Kirchgässner/Schaltegger (2003) for a survey of the empirical evidence that mostly conforms the decentralization hypothesis of Brennan/Buchanan (1980, p.185) that "total government intrusion into the economy should be smaller, ceteris paribus, the greater the extent to which taxes and expenditures are decentralized". Although some empirical studies deny this effect, the Swiss experience clearly shows that tax competition favors a smaller size of government (and shifts government revenue from taxes to user charges). The

Therefore, I would rather like to stress the evolutionary merit of inter-jurisdictional competition that goes beyond its limiting role. Competition beyond borders can also have an enabling function – for citizens and politicians alike. Competition, also political and inter-jurisdictional, benefits from and creates Humboldt's "varieties of situations"; it is in Hayek's (1968/78) terms, a "discovery procedure".

Competition between political alternatives (be they ideas, party platforms, or whole legal systems), like market competition, is justified primarily on the grounds that we do not know in advance which opinions and alternatives exist and which policies under which conditions are considered 'right' or 'acceptable' by those who have to endure them. Thus, very much like Hayek's (1968/78, p.179) advocacy of the freedom to compete ("if anyone really knew all about what economic theory calls the *data*, competition would indeed be a very wasteful method of securing adjustment to these data"), one could state: if anyone knew all about political opinions and opportunities, which most of the economics of politics treats as data (given preferences, given issue-space), also political decentralization and competition would be a rather wasteful method and a government by élite consent may be preferable. From an evolutionary-liberal position, our lack of knowledge and hence the high probability of mistaken perceptions and theories does not represent a problem. On the contrary, the dispersion and lack of knowledge provides the main justification for political competition. As Hayek (1978, p.148) put it: "more successful solutions of the problems of society are to be expected if we do not rely on the application of anyone's given knowledge, but encourage the interpersonal process of the exchange of opinion from which better knowledge can be expected to emerge".

These arguments support even more the idea of supplementing representative democracy with direct democracy and inter-jurisdictional competition. General elections do not *continuously* signal citizens' opinions on *particular* policies. By focusing on specific acts of legislation, referenda and popular initiatives communicate political preferences much more concretely. Even more importantly: they provoke political opinion formation as a result of deliberation focused on concrete alternatives, thus leading to the creation and social use of political skills and knowledge in society. In addition, if combined with fiscal decentralization and fiscal referenda, direct democracies tend to reduce the state's power to tax[28].

Inter-jurisdictional competition ("exit"') also expresses popular discontent, albeit more indirectly (than "voice")[29]. Compared to voting for representatives, exit entails the individual choice of rules instead of a collective choice of rulers (Wohlgemuth 2008). It is based on individuals' comparative appraisals of the net benefits of combining their mobile resources with various existing political infrastructures in alternative jurisdictions. Using exit, individuals can free themselves (to some extent) from forced consumption of political goods and communicate the results of their comparative institutional analysis via personal decisions. As an ongoing selection mechanism, exit is therefore much more likely to provide political analogues to evolutionary market competition and to the system of relative prices as devices for the discovery and use of local knowledge. Inter-jurisdictional competition qualifies the monopoly power of governments and enables citizens to actively choose between concrete sets of political alternatives; it introduces a politically effective form of parallel rather than consecutive innovation and learning from real-life experiences (Vanberg 1993, p.15).

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observation that adherents of "positive welfare" on the left tend to associate themselves with very conservative nations of national "sovereignty" to be defended against "fiscal federalism", "tax competition" and "globalization", whereas classical liberals welcome open borders and inter-jurisdictional competition as an expression of individual sovereignty and as a means to limit government to me is indication enough that both camps are right in their fears or hopes.

[28] See Feld et. al. (2008) or Feld and Kirchgässner (2001) for evidence mostly with reference to Swiss experiences with popular democracy.

[29] See Hirschman (1970).

Again, neoclassical accounts of inter-jurisdictional competition can produce both: welfare-enhancing effects (following the seminal contribution by Tiebout 1956) or welfare-destroying effects (following the tradition of Musgrave 1959). Whether a 'race to the top' or 'a race to the bottom' is more likely to emerge depends critically on initial assumptions about the political status quo. Starting from the assumption of the state as the ideal provider of public goods, any change triggered by competitive pressures is likely to lead 'downhill'. Starting from a 'Leviathan' model of political misuse of its monopoly, exit and 'yardstick competition' is very likely to make citizens better off.

Compared to these 'pure' theories that treat political preferences as given and known, and the consequences of (given) alternative policies as equally beyond doubt, evolutionary theories that regard political opinions and political problem-solutions as fallible 'hypotheses' offer additional, more realistic arguments – mostly in favor of open borders, decentralization and inter-jurisdictional variety and mobility (Wohlgemuth 2008). Evolutionary political economy tends to raise different doubts about harmonization and centralization, e.g., in the European Union or federal states. Issues such as 'experimentation', 'discovery', 'correction of errors' (or limitation of the scale of errors), 'learning', 'reversibility' are standard currency for evolutionary thinkers; they do not devaluate standard economic issues such as 'efficiency', 'allocation', or 'incentives'. But they add important aspects that deserve attention in positive analysis and normative advice.[30] This also holds for my following analysis of the boundaries of today's Europe.

5. The European Union: too big and too small

Where are the borders of Europe? And: what are the limits of the activities of the European Union? The first question is especially intriguing to ask here in Istanbul where many claim that one border runs right here in the middle of the Bosporus. The second question is especially urgent to ask at a time when many claim that the EU (and the ECB) have gone beyond legal boundaries that were set to limit their authority – and that the EU is developing into an interventionist "super-state".

Let me retrace my steps and give you my account of the overall (mis-)construction of the EU. My argument is that, right from the beginning, the Union has been both too big and too small – both in terms of size (membership) and scope (intensity). Or, in Humboldt's words, European integration has not (enough) been lead by the principles of individual liberty and the variety of situations. This can be shown by means of rather simple intuitions of economic club theory.

Club-theoretical intuitions[31]

James Buchanan (1965) initiated an immense club-theoretical literature. While Buchanan focused on one club good only, more recent approaches analyze clubs that produce multiple goods. Moreover, club theory has been applied to international issues and international organizations such as the EU (Brueckner/Lee 1991; Cornes/Sandler 1996, p.404ff, Ahrens/Hoen/Ohr 2005).

As a simple definition, clubs are voluntary associations formed by individuals to pursue a common goal – the provision of a club good. Originally, the theory of clubs was meant to overcome Samuelson's dichotomy between pure public and pure private goods with club

[30] On fiscal federalism as a 'laboratory' that allows learning from policy innovations in other states see Oates (1999), on interjurisdictional competition as a creative discovery procedure and learning device see Vihanto (1992), Kerber/Heine (2003), Wohlgemuth (2008). On "yardstick competition" and the pressure for policy imitation or innovation, see Besley/Case (1995) or Rincke (2005).

[31] This part summarizes some basic ideas developed with Claudia Brandi (Wohlgemuth/Brandi 2006 and 2007).

goods ranging somewhere in between. Accordingly, club goods display two defining attributes:

(a) they are non-rival in consumption to club members (or only partially rival, i.e. non-rival up to a certain number of members), which means that if one member benefits, this does not reduce the amount of benefits for other members;
(b) the benefits of club goods cannot be enjoyed by non-members, i.e. exclusion is possible. This prevents free-riding; if a member does not pay his dues or perform his duties, she can be deprived of the benefits of club membership.

Club theory helps identify the optimal size of the association both in terms of the optimal number members and the optimal intensity of club goods to be produced. The optimal club size is reached when marginal benefits for the club members from accepting an additional member are just equal to the marginal costs that are incurred from adding one more member to the club. Traditional club theory often assumes partial rivalry of club good benefits implying that a large number of members will result in "crowding" or "congestion" effects which reduce the quality of the goods and services provided by the club. Moreover, traditional club theory assumes that per capita production costs decrease with an increase in the number of club members because provision expenses associated with the club good will be shared among more members. These assumptions, whilst appropriate in the case of swimming pools or golf clubs, are not necessarily adequate in the European Union as a club. Some important specifications include:

One should conceptualise the EU as a club of states, not individuals. Also, the EU provides a variety of club goods to its members[32]. And most importantly, not all club goods are necessarily "good" for all members – some might be (or turn out to be) "bads". The EU's "aquis communautaire" does not at all "offer" a "variety of situations", but makes it obligatory for all (now: 27) member states to transform into national law some estimated 500 000 pages of European laws, regulations and directives. This "uniformity" of Europe's "one size-fits-all" approach to integration must come at a cost, as I shall try to show now.

2.2 Deeper or wider Union?

Deepening or widening the European Union has always been a matter of dispute amongst European élites (European citizens were rarely asked on both accounts). Here, the trade-off between boundaries (size of EU-government) and borders (size of the Union) has always played a strategic role: The deepening-sceptics (such as leaders in the UK or the Czech Republic) are very much in favour of enlargement whilst keeping unanimity decisions in the Council (of ministers or heads of state) intact; their motive: widening would forestall even further deepening. The deepening-enthusiasts (such as leaders in France, and Germany), in turn, stress the "absorption capacity" – which includes the further centralization and

[32] These include the guarantee of the "Four Freedoms", i.e. the free movement of goods, services, persons and capital through the Internal Market; external and internal security through a common foreign and security policy (CFSP) and police and judicial collaboration in criminal affairs. Further examples of European club goods are the definition of environmental and product standards and (as selective sub-club-services) a single currency through membership in the EMU, the Schengen Agreement and Convention and the Western European Union. Additionally, stronger coordination in social, employment, industrial and education policies has been put on the European agenda striving for EU-wide harmonized standards and centrally provided policy instruments. All of the above goods have in common that they are (i) non-rival (or only partially rival) in consumption and (ii) that non-subscribers to the respective agreements (be that within-EU-treaties or bilateral treaties of third countries with the EU) are excluded from their consumption. Therefore these goods qualify as club goods.

harmonization capacity – of the Union which tends to decrease with the capacity or willingness of new members to accept the blessings of an increasing "acquis".

Both strategies make rational sense – but still: the trade-off between limits and borders, between deepening and widening the Union is tragically bound to not allowing a Humboldtian "diversity of situations" to develop within the Union (and its member states as well). It is the combined assumptions of "once and for all", "one size fits all" and "all or nothing" that are at the heart of Europe's misconstruction. Both economic club-theory and common sense can make this clear. In the following passages I briefly discuss three remarkably different integration areas of the EU in order to demonstrate in which ways both benefits and costs of integration are contingent on the "boundaries of the EU" both in terms of membership and intensity.

a) The Internal Market Club

EU club goods corresponding to the Internal Market include the "peace dividend" derived from mutual gains from trade and enhanced international division of labour and knowledge. All members gain by being in the Internal Market club which results both in static and dynamic efficiency gains. These gains are larger, the more members the Internal Market club has. As Adam Smith (1776) already knew: "the division of labour is limited by the extent of the market". Hence, there is no direct rivalry in club good usage; to the contrary, additional members promote the welfare of given members.

If the EU were only a free trade area, it would be too small. The optimal size of a free trade agreement is the world. A pure disarmament club merely focused on the prohibition of trade intervention or enforcing negative liberty rights would barely be dependent on scarce resources like tax-payers money or the enlightened consent of citizens, as Hayek already argued in 1939[33]. But positive regulation concerning political integration, which can – at least partly – be useful for the functioning of the Internal Market, is a different matter.

With respect to positive regulations such as competition rules, consumer protection rules or production standards within the EU, active collective choices are necessary and political views and capacities diverge. As a consequence, decision-making costs rise. These costs are kept relatively low by delegation to the Commission. However, the natural centralization and harmonization drive of a central bureaucracy can result in increasing external costs as the EU-club becomes larger, more heterogeneous and more actively interventionist[34]. A "complete" Internal Market à la Brussels, therefore, has a finite optimal club size.

b) The Monetary Union Club

The club good corresponding to the Euro-zone (EMU) is the single currency. The politicians' great hopes (ignoring many economists' warnings) were manifold. Some may relate to pure strategic games of power-politics (such as the wish to escape the implicit reign of the German *Bundesbank* over European monetary policies or to use monetary union as a Troyan horse establishing a fiscal union afterwards or to free-ride on the low interest rates justified by the

[33] See Hayek (1939/80, p.255) who argued that "the establishment of economic union will set very definite limitations on the realization of widely cherished ambitions",and that "the federation will have to possess the negative powers of preventing individual states from interfering with economic activity, although it may not have the positive power of acting in their stead" (p.267). See Wohlgemuth/Sideras (2004).for more details on this argument. We also find that, lacking a clearer view of Public Choice, Hayek's vision was somewhat over-optimistic.

[34] "External costs" in the sense of Buchanan/Tullock (1962) occur when a participant in a collective decision has to accept a collective choice that does not reflect her preferred alternative (see Wohlgemuth/Brandi 2006 for a wider application of this concept to European decision-making).

relative robustness of other Euro-members). Other hopes were based on more (economically) rational grounds such as reduced transaction costs and currency risks which can lead to more trade, economies of scale, intensified competition and thus general welfare gains.

However, as now has turned out to be a tragic mistake, the experiment was too bold membership too comprehensive. EMU members are now realizing the consequences of being deprived of two crucial policy instruments and market stabilizers: monetary policy (interest rates) and exchange rates. I cannot here discuss the details of how this created early on an unsustainable credit-boom in the formerly high-interest (low competitiveness) periphery and many years of stagnation in Germany[35]. The basic economic rationale is simple enough: The more heterogeneous the economic structures of the EMU member countries are, the more their economic policy objectives diverge and the more divergent the endogenous and exogenous economic shocks affecting EMU member states are, the less will a common inflation goal, a uniform interest rate policy and a common external currency value be consistent with reasonable adjustment strategies of individual member states.

c) The Common Agricultural Policy Club

Finally, the EU engages (with still the largest part of its budget) in "solicitudes of positive welfare" that already Humboldt (p.21) maintained are "positively hurtful in their consequences, and wholly irreconcilable with a true system of polity": "the encouragement of agriculture, industry, and commerce". And it does so on a scale of a market with some 500 million peoples! Obviously hurtful policies such as the Common Agricultural Policy (CAP) have an optimal club size of *zero*. There is no economic mutual benefit of a policy that deliberately raises consumer prices, generates overproduction, administrative costs and devastates the prospects of poor countries.

5.3 Flexible voluntary integration

As suggested by many observers (see Wohlgemuth/Brandi 2007; Siedentop 2000; Alesina et. al. 2001), the extent of current policy harmonization in the *acquis* is too large because it includes policy fields in which the benefits resulting from the exploitation of scale economies and the internalization of externalities are much smaller than the external costs caused by policy centralisation. This would imply that the number of integration domains currently included in the *acquis communautaire* ought to be reduced and transformed into a core-acquis comprising only those policy fields for which harmonization offers clear mutual gains.

In this context, the Union would act as a "guardian" of the core-*acquis* and as a "broker", "monitor" and "arbiter" of a variable structure of open, flexible, competing integration clubs[36]. According to this approach, all members of the EU are members of the core; membership in the various sub-clubs is optional. Thereby, the club-of-clubs approach allows for different intensities of membership in the EU; yet, in contrast to the concentric circles model, the focus is on policies, not on countries. In other words, flexible integration would be functional rather than geographical[37].

Flexible integration according to the clubs-within-the-club strategy, a process by which all member states agree to disagree about their priorities but permit their members to go

[35] See, e.g. Sinn (2010) on the fundamental reasons of the present Euro credit and balance of payments crisis.
[36] Frey/Eichenberger (e.g. 2000) were amongst the first to suggest flexible, overlapping, competing jurisdictions.
[37] The concentric circle (but also: Europe à deux vitesses) approach is much more rigid than the club-of-clubs strategy. According to the concentric circles approach, flexibility is implemented by a system of derogations and opt-outs and the integration sequence is fixed in advance. Our approach would be more flexible by giving member states complete freedom to create new forms of cooperation or deepen existing ones and by keeping no member from leaving any sphere of integration. Our model pictures Europe to consist of member countries as members of different clubs rather than as one single club with different classes.

ahead with objectives which they share as a sub-group, caters both to the divergent needs of individual member states and to the disparities of economic and political structures in a heterogeneous group of 27 and more countries. At the same time, the clubs-within-the-club approach breaks down one high integration hurdle – the *acquis* – into a lower one – the core-*acquis* – and various optional hurdles.

Since no member is required to accept any common policy that it dislikes, external costs (inadequate collective decisions in the sense of Buchanan/Tullock 1962) would be significantly reduced. Moreover, decision-making costs would be considerably lower for decisions made in various smaller and more homogeneous clubs than for decisions made in the overall Union. This enlarges the "variety of situations"; however, not country by country in an all-or-nothing way, but issue by issue, according to national citizens' needs and preferences.

The remaining core-*acquis* "minimal Union" should contain well-defined integration areas for which integration is regarded as essential, the most important of which are the basic, Kantian "universalizable" provisions of the Internal Market[38]. With the exception of the Internal Market there is no theoretically unchallenged consensus about which policy fields should be in the core – whose optimal size would be infinity after all[39].

It is not the idle product of ideal-type economic reasoning to imagine several different-sized EU-sub-clubs with various members across different policy fields instead of one single overall EU-club comprising 27 and more heterogeneous members. Even though they are still exceptions, there already are a number of different-sized "sub-clubs" within the EU. While, for instance, the Internal Market covers all EU members, some policy clubs comprise only a subgroup of EU-members, such as the EMU, and some embrace several EU-members as well as non-EU-members, such as the Western European Union (WEU).

Conceiving the EU as a club of clubs is not only consistent with neoclassical economics; it is also compatible with the basic "mutual gains" notion of the contractarian constitutional paradigm which is all about "seeking to explore potential gains from cooperation" (Vanberg 2003, p.18). In view of this paradigm, we can summarize the advantages of flexible instead of one-size-fits-all integration.

(a) Combination of commitment and flexibility. The club-of-clubs procedure allows for greater variety and diversity without endangering the great achievements of European integration, namely the Internal Market and the "Four Freedoms". This model yields a combination of commitment and flexibility that is superior both to the status quo and to other proposals for flexible integration like multi-speed or concentric circles.

(b) Reduction of integration costs. Although administrative costs might increase as a consequence of dealing with numerous (sub-) clubs, our model may in sum be relatively cost efficient. With voluntary club-formation amongst the capable and willing, the costs of finding consensus will decrease. A decentralized, competitive process of voluntary club formation would also lower external costs because countries, and possibly sub-national units, can search for cooperation regarding those functions in which they have a real

[38] Wohlgemuth/Sideras (2004, p.20f) argue that the provisions of the Internal Market contain key elements of an universalisable order resembling Hayek's (1939/80) vision of "Interstate Federalism".

[39] See also Harrop (2000, p.308) or Warleigh (2002, p.64). According to Alesina et al. (2001), the "hard core" should also include international trade policy and anti-trust. Moreover, it may contain convertibility of currencies, a Common Foreign and Security Policy (CFSP) as well as police and judicial cooperation of all EU members in criminal matters that show cross-country externalities. For instance, the clubs-within-the-club approach may be a useful means to strengthen the operational side of cooperation in the field of security policy via trans-national police forces, border guards, a European judicial area and intelligence cooperation. See also Feld (2003: 308) on judicial cooperation in cross-country criminal matters like protection against terrorism and Persson et al. (1997, p.26) on political economy reflections on why there is reluctance to centralize defence policy.

demand for cooperation, and they are not forced into cooperation with respect to functions for which there is no such demand. Voluntary entry and exit may also reduce the risk of blackmailing by veto-players and necessity for mutual haggling over privileges via log-rolling against the common interests of citizens (Wohlgemuth/Sideras 2004, p.23).

(c) *Responsiveness to citizens' preferences.* Institutional competition and thus the freedom of citizens to choose between institutional arrangements of numerous clubs that involve different costs and benefits, alongside the freedom of clubs to modify and differentiate their institutional supply, should lead to a better alignment of policies with citizens' preferences (and stricter limits to the states' power to tax and intervene, see part 4). Inter-jurisdictional competition among the various integration clubs should enhance citizen sovereignty and make self-interested politicians more responsive to citizens' interest (Vanberg 2000: 363). The threat of dissatisfied citizens opting out – thereby foregoing their net contribution to the club good – provides an incentive to take individual preferences into account and to provide the respective club good efficiently.

(d) *Flexible Integration as an evolutionary "discovery procedure".* The club-of-clubs concept is process-oriented: while it specifies the process of club formation (for example, how new clubs may be established), it does not determine the club-of-clubs outcome (for instance, what functions are to be provided by which club). Thus, competition among the various clubs can serve as a knowledge-creating "discovery procedure" of such political preferences and problem solutions "as, without resort to it, would not be known to anyone, or at least would not be utilized" (Hayek 1968/78, p.179, see above). In evolutionary terms, club competition should also be a less risky procedure to identify and correct political mistakes and to react to a continuously changing variety of preferences and problems. Without competition among different forms of integration, inaptly "harmonized" or centralized "policy-hypotheses" are – for lack of observable and selectable alternatives – hard to identify. Moreover, without competition among policy-clubs, the existence of irreversible path dependence is more likely because – due to complex logrolling agreements – mistakes, even if they are detected, can hardly be revised in "integrated", interwoven policy cartels.

Today, there is an increasing concern with the Union's "finality", its "borders" or its "absorption capacity". Puzzled by the popular rejection of its "constitution"-project, overwhelmed by the recent enlargements, and motivated by a more or less hidden uneasiness with a potential accession of Turkey, most leaders see the EU "at the crossroads" with no clear "roadmap" at hand. All this metaphoric talk, accompanied by an escape to symbolic politics (e.g. "Lisbon agenda"), sounds at times rather esoteric to a more pragmatic economist. But these concerns do seem justified as long as both the given integration status and traditional integration strategies are taken for granted. With a heavily inflated *acquis*, an non-transparent and often inefficient use of a large portion of the EU's budget, cumbersome decision-making procedures and growing popular disenchantment with "Brussels", further enlargement and deepening must almost necessarily be regarded as contradictory purposes of the Union.

"Finality", "borders" or "absorption capacity" owe their dramatic and gloomy clout to the traditional combination of two unnecessarily holistic and constructivist ideologies: "one-size-fits-all" (for full-member-states) and "all-or-nothing" (for would-be member-states). Both fronts seem now slowly to relax. But a more radical relaxation, as proposed in our club-model, seems to offer a much more adequate solution to many concerns troubling European governments and citizens. Both deepening and widening could be achieved simultaneously, if they were based on integration of the capable and willing in specific policy areas where consent can be found without the traditional resort to power politics, bundling special interests from diverging policy fields.

Our model of a Union of clubs in addition to a common *acquis* reduced to an undisputed and reasonable core of universalisable policies also has implications for the European Neighbourhood Policies (ENP). Current ENP-strategies have noble causes, to be sure. At the same time, they seem to be aimed at calming and comforting both EU neighbours (potentially want-to-be-members) and existing EU members by offering cooperation (and financial support) without full membership – which would indeed pose grave problems of absorption capacity of the EU and adoption capacities of our neighbours. Our model offers much more immediate and flexible comfort. Full membership would be reduced to such core-areas where mutual gains from joint commitment can be offered to both the existing and to many new members. Hence, it would be comparatively easy to turn "neighbours" into "members", e.g. of a core Union based on free trade or political coordination in Humboldt's fields of the true state activity such as common defence and security.

Europe does not have to hurt to be good[40].

6. Conclusion

At least in Europe, a truly Humboldtian minimal state (if ever there was one), has become a most daring vision. Today Europe is much rather bound to further betray her classical liberal heritage. By ways of "harmonizing" and centralizing more and more "solicitudes of "positive welfare" over more and more citizens, the EU destroys the vital elements that once created the "European miracle": individual freedom and "the diversity of situations". As Wilhelm Röpke (1960, p.244) put it with great emphasis: "Decentrism is of the essence of the spirit of Europe. To try to organize Europe centrally, to subject the Continent to a bureaucracy of economic planning, and to weld it into a block would be nothing less than a betrayal of Europe and the European patrimony".

Times of crisis can make things worse; but a possible break-down of the monetary union may provide an opportunity to rethink the overall construction of the Union. The proposal developed in this paper is one option that may in some form suggest itself. It would at least bring the EU's "core aquis" closer to Humboldt's minimal state. It would give citizens greater freedom and availability of diversity. By thus fostering institutional competition, it would at the same time impose stricter limits on national governments and lead to the discovery of better political problem solutions.

As political borders become less important for economic (and military) viability, there can be more (smaller) states – both in terms of nation size and of state activity. Perhaps the best we can hope for is more, open, borders to lead through the "invisible hand" of competition and "exit" to more effective "boundaries of the state".

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[40] This final „punch-line" refers to a quote of another classical-liberal who served as public servant to the European Commission, Lord Dahrendorf (1979): "I have often been struck by the prevailing view in Community circles that the worst that can happen is any movement towards what is called a Europe à la carte. This is not only somewhat odd for someone who likes to make his own choices, but also illustrates that strange Puritanism, not to say masochism, which underlies much of Community action: Europe has to hurt in order to be good."

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