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Testing For Subsidiarity*

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Abstract

In the EU circuit (especially the European Parliament, the Council and Coreper) as well as in national parliaments of the EU Member States, one observes a powerful tendency to regard 'subsidiarity' as a 'political' issue. Moreover, subsidiarity is frequently seen as a one-way street : powers going 'back to' Member States. Both interpretations are at least partly flawed and less than helpful when looking for practical ways to deal with subsidiarity at both EU and Member states' levels.

The present paper shows that subsidiarity as a principle is profoundly 'functional' in nature and, hence, is and must be a two-way principle. A functional subsidiarity test is developed and its application is illustrated for a range of policy issues in the internal market in its widest sense, for equity and for macro-economic stabilisation questions in European integration. Misapplications of 'subsidiarity' are also demonstrated.

For a good understanding, subsidiarity being a functional, two-way principle neither means that elected politicians should not have the final (political!) say (for which they are accountable), nor that subsidiarity tests, even if properly conducted, cannot and will not be politicised once the results enter the policy debate. Such politicisation forms a natural run-up to the decision-making by those elected for it. But the quality and reasoning of the test as well as structuring the information in a logical sequence (in accordance with the current protocol and with the one in the constitutional treaty) is likely to be directly helpful for decision-makers, confronted with complicated and often specialised proposals. EU debates and decision-making is therefore best served by separating the functional subsidiarity test (prepared by independent professionals) from the final political decision itself. If the test were accepted Union-wide, it would also assist national parliaments in conducting comparable tests in a relatively short period, as the basis for possible joint action (as suggested by the constitutional treaty).

The core of the paper explains how the test is formulated and applied. A functional approach to subsidiarity in the framework of European representative democracy seeks to find the optimal assignment of regulatory or policy competences to the various tiers of government. In the final analysis, this is about structures facilitating the highest possible welfare in the Union, in the fundamental sense that preferences and needs are best satisfied. What is required for such an analysis is no less than a systematic cost/benefit framework to assess the (de)merits of (de)centralisation in the EU.

Key words: subsidiarity, economics of federalism, fiscal federalism, optimal EU assignment of public economic functions.

JEL Codes: H11, H77, F15.

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1. Introduction

The Convention on the future of the Europe and the Treaty establishing a Constitution for Europe have moved subsidiarity much higher on the political agenda in the EU. It is possible that its application will become a permanent priority issue for political actors. Nevertheless, there is a lot of confusion and controversy about subsidiarity. Indeed, one often hears doubts expressed on the operational usefulness of the principle in the EU. Many political actors, in the Convention as well as in many debates in the EP, the various Councils of the Union and national parliaments, routinely take the view that subsidiarity is inherently "political", although what that means is rarely, if ever, spelled out in a verifiable manner.

Economists enjoy a long tradition in studying subsidiarity as a functional principle, in contrast to both European law and political science.¹ The present paper will attempt to explain the functional approach to subsidiarity in an accessible fashion, with many illustrations in different policy domains. It is hoped to contribute in this way to a better interdisciplinary understanding of subsidiarity. Thus far, law, political science and economics have each moved, so it seems, in 'trenches' without showing much interest in the insights of other disciplines. But in sticking to one's own narrow perspective, the credible underpinning of a sensible application of subsidiarity for the better functioning and acceptability of the EU is and remains unduly hampered. With subsidiarity so high on the EU political agenda, what the Union needs is a considerable degree of cross-disciplinary appreciation of different useful and legitimate perspectives: it can serve its application well, for political actors, numerous stakeholders and of course ultimately the hundreds of millions of voters in the EU. With this purpose in mind, the present paper will explain the functional analysis underpinning a "subsidiarity test".

The paper is structured as follows. Section 2 explains the assumptions and underpinning of the economics of federalism, encapsulated in the principle of subsidiarity. It shows that the criteria in art. 5, EC, form a useful basis for a subsidiarity test justified by economic analysis, irrespective of whether it is utilised for existing shared competences or for treaty design.

¹ See Pelkmans, 2005, for a juxtaposition of the legal and economic literature on subsidiarity. In political science, the subsidiarity debate is mainly about political legitimacy (which may or may not be functional) and power struggles between different layers of governments.

In fact, *subsidiarity and proportionality together amount to nothing else than a cost/benefit analysis of (de)centralisation*. It also provides the five-steps subsidiarity test and explains its rationale as well as the proper and improper application. Sections 3, 4 and 5 provide brief accounts of the application of the test to the three public economic functions of the EU multi-tier government: efficiency, equity and macro-economic stabilisation. Section 3 is mainly about the internal market in its very wide conceptual meaning, that is, what economists call the "allocation function" of the state. Aspects to be addressed include, first, the functional pressures for more centralisation once liberalisation deepens and widens, the misuse of the 'subsidiarity' flag when resisting genuine free movement, political resistance to (modest degrees of) centralisation where a subsidiarity test can show how 'dysfunctional' (costly) this may be, the utility of the test when the boundaries between (undisputed) national competences and functional EU complementary action are shifting and, finally, the question whether there is a solid case for the EU providing 'public goods' as the economic theory of federalism might suggest. All these aspects will be illustrated by concrete examples. Section 4 asks the question whether the EU has equity assignments comparable to those referred to in the economics of federalism literature. Perhaps surprising to some, the answer will be negative. Section 5 employs a subsidiarity perspective to investigate the current EU mix of centralisation (of monetary policy) and decentralisation (of fiscal and other 'economic' policy) in macro-economic stabilisation, especially in the eurozone. These three sections should show to the readers that the potential of the subsidiarity perspective, and of the test as a corollary, is very considerable. However, the complete separation between the 'functional' and the 'political' angles of looking at subsidiarity - though indispensable for a professional application of the test itself - is unsatisfactory if one wishes to understand the subsidiarity debate in the EU. In section 3, examples are provided where a dysfunctional approach to subsidiarity is employed for political reasons. Apart from public choice, more recently applied to the EU as well, a strand in economic literature based on government failure (that is, the EU being too weak on accountability and responsiveness to voters) is developing. In section 6 a flavour of this approach is given by removing the assumption of pure functionalism underlying the test, that is, benevolent governments and other public actors (e.g. bureaucrats and eurocrats) and the absence of pressure groups. The removal of this assumption explains certain features of today's Union which do not accord well with a functional analysis of subsidiarity and proportionality. Section 7 concludes. The reader should note that we refrain from a literature survey of the economics of subsidiarity as developed in the EU context.² The focus will be on the explanation of the functional logic and the subsidiarity test (though not technically), with an emphasis on the application to a range of domains under "shared powers" as well as complementary powers.

² For the early literature the interested reader is referred to Tinbergen (1954 ; 1956), the MacDougall report (1977, especially Volume II with an anonymous essay on applying the subsidiarity principle to no less than 75 potential public economic functions of the EEC as well as the contribution of Forte in that volume), Pelkmans (1982), Pelkmans (1985) and the Padoa Schioppa report (1987, dealing in detail with the economics of subsidiarity when answering the question from president Delors what the *systemic* consequences could be of a truly single market for the three public economic functions in the Community, namely, efficiency (of the internal market), equity and macro-economic stabilisation).

2. The basic economics of federalism and the subsidiarity test

2.1. Optimal (de)centralisation

The starting point of the economic theory of federalism (or, in the EU context, of multi-tier government) consists in asking the question whether centralisation of public economic functions is welfare improving. The answer is that all-out centralisation is bound to be sub-optimal (see below why). In federal countries this leads to the problem of the optimal degree and forms of *decentralisation*. However, in the process of economic integration between countries which retain the sovereignty to transfer (or not) powers to a common level, it leads (*mutatis mutandis*) to the problem of the optimal degree and forms of centralisation. In purely analytical economic terms, and abstracting from politics, these two questions should functionally come to the same answer. However, the current state of economic integration and Union building in Europe – advanced though it is - is politically so radically different from a federation operating as a single country that such a purely theoretical approach adds more to confusion than to insight.

2.2. Great caution before applying 'economic federalism'

There are four critical differences between European integration and a federal country. First, the political logic of ever more ambitious economic integration is very different indeed from the logic of (economic) decentralisation in a mature federation. Of course, in Europe this is well-known and a routine inspection of the minutes of the Convention plenary and the 11 Working Groups reveals many examples of inhibitions. Whereas a considerable degree of centralisation is an established fact in federations, be it with significant variance between federations, the political costs of even minor shifts to more economic or institutional centralisation weigh heavily in European integration. And until today every country has veto power on any treaty-based shift, a power which profoundly influences any proposals for centralisation in the first place. The Convention has thrown off the taboos and inertia of the Nice IGC but, while deepening the debate and better appreciating numerous options, this is a far cry from a functional re-design of the treaty into a Constitution with a *federal* logic.

Second, an advanced degree of completion of the internal market must itself be politically acceptable before the economics of subsidiarity can be usefully applied. The completion of the internal market can be justified economically by typical subsidiarity criteria but that would often be correct at world level too. However, such deepening entails profound and manifold consequences for the domestic capacity to regulate markets, protect workers or consumers and maintain the welfare state, to mention only some of the main aspects. These state activities usually result from intense political debate, based on local preferences. Once there is a minimum willingness to accept a high degree of liberalisation, with sufficiently strong mechanisms to formulate joint regulation where appropriate, the logic of economic integration begins to apply. In that event it might lead to what political scientists call “spill-

over”,³ that is, a positive complementarity between policy domain A (say, part of the internal market) and policy domain B. Once domain A is firmly integrated it becomes more attractive – possibly welfare improving - to integrate domain B as well. Such dynamic complementarities are not well modelled in economics or political science but there is a widespread conviction that they tend to explain the almost continuous deepening and widening in the EU over decades, given a credible minimum of internal market accomplishments. As a result the stages of economic integration become ever more ambitious and the subsidiarity question has to be posed ever more insistently.

The EU is still the only instance of regionalism where not simply internal free trade prevails but indeed free movement, credibly enforced moreover by a common guardian (the Commission) and a supreme Court. This deep commitment to the internal market is ultimately a political prerequisite for the sensible application of subsidiarity. At the far end of the spectrum this commitment can be perceived as “federal”. Elsewhere on the spectrum it all depends. In the EU the national labour markets are still protected like fortresses and the so-called “free” movement of workers (in art. 39, EC; however in art. 3, EC only persons) does not refer to a significant degree of *economic* freedom at all. Distortions that would never be acceptable under caselaw for goods, services or capital do not even raise an eyebrow when it comes to labour markets, mutual recognition does not apply (see the intrusive analysis by Fiorella Kostoris Padoa Schioppa, 2003) and approximation and other forms of central governance in this area are largely taboo. As we shall see, this political fact of refusing to go for an internal market for labour pre-empts powerful complementarities to emerge and this, in turn, profoundly affects the results when applying a subsidiarity test.

Third, the EU still lacks a number of properties that are taken for granted in a federal country. Since 1999 it has a single currency but there are still three “outs” in the EU-15 and thirteen since May 2004. The EU has no right to tax, no common army or defense and more an uncommon than a common foreign policy. Even the customs, though operating on exactly the same rules and bound into a common information and management system everywhere, has remained national, despite the courageous abolition of internal frontiers. In all these instances the economics of subsidiarity yields firm conclusions in favour of at least somewhat (more) centralisation, yet politically it remains taboo.

Fourth, the EU has no central government.

2.3. Making the economic case for centralisation

Given these political constraints, we can now return to the question why all-out centralisation is bound to be sub-optimal. Welfare improvement is always a matter of the (better) satisfaction of preferences. If a representative democracy is capable of revealing the preferences of the voters well, the satisfaction of voters’ preferences will be the more likely, the closer the government is to the voters. There are two reasons for this: on the one hand, proximity to voters will enable policy makers to “read” the preferences better than more

³ Not to be confused with what *economists* call spill-overs, see further.

distant policy makers, and on the other hand, policy makers at the local or regional level will be able to respond to such revealed preferences without having regard to the preferences of other localities or regions, unlike a higher tier of government. In the ideal system, at least for the sake of preference satisfaction, there should be three means of enforcement or discipline: voice, replacement of policy makers and exit. *Voice* refers to the many ways voters express views in between elections as well as in the elections themselves; the probability of re-election drives policy makers. Policy makers who do not respond to revealed preferences can also be *replaced* and locally this process can be geared to local issues. *Exit* refers to movement to other localities or regions in response to a disregard of preferences. If exit is costly in financial or socio-cultural terms, local policy makers enjoy more discretion.

These elementary points underlie the priority that the subsidiarity principle gives to decentralisation. In the theory of multi-tier government the subsidiarity principle is simply an assignment rule for *optimal institutional design*: close correspondence of public policy with voters' preferences will often require the assignment of policy competences to local government. For all-out centralisation to be optimal, one would have to make very extreme assumptions like congruent preference sets for all voters in all localities or regions and the full information at the central level about these preferences, or, alternatively, full information at the central level about the differences in regional preferences and the unrestricted capacity at the central level to differentiate any policy or rule at every level so as to satisfy these preferences at very low costs. It is from the rejection of such pointless abstractions that the subsidiarity principle derives its bias towards decentralisation. It follows that the case for centralisation has to be made.

However, this is not the end but merely the beginning of the story. The implicit assumption in the reasoning so far is that localities or regions are not in any way interdependent. Moreover, there is no mention of cost: certain preferences may require public policies which are too costly to provide locally or even regionally but could be payable if provided by a group of localities or regions or even countries. The *interdependence* between regions in a modern economy is of course very strong. The nature of such interdependence will affect a rational assignment of powers. Cross-border externalities⁴ between regions or countries linked together by markets and otherwise can be negative or positive. Positive externalities imply that the local effectiveness of the measure taken in region A is reduced by the positive effects it has on the policy objectives of region B. Decentralisation can then generate a typical prisoner –dilemma in that a refusal of region B to cooperate or pay will make A reticent to persevere with the measure, with the result that too little is done (hence, satisfaction of preferences is less than possible). At a higher level of government this externality can be internalised. Negative externalities are conflictuous as they result from “beggar-thy-neighbour” policies: the effectiveness of a measure taken in region A is at the expense of welfare in region B. Examples include cross-border pollution or trade protection. Prohibitions or common rules at a higher level of government can internalise these problems.

⁴ Or spill-overs, in economics.

Where policies are *costly*, especially if the minimum fixed costs are high before any provision is feasible, economies of scale may militate against decentralisation. CERN, the particles accelerator in nuclear physics near Geneva, is supported by many countries for reasons of scale. This example shows that scale, as an argument to move away from pure decentralisation, need not automatically imply centralisation; durable cooperation may do very well.

Therefore, the case for centralisation under subsidiarity hinges on scale and cross-border externalities arguments. Note that this assignment to a *higher* level on functional grounds is just as much “subsidiarity” as the a priori presumption that preferences tend to be better satisfied by *local* government. Subsidiarity is a two-way principle!! Its initial bias might be towards decentralisation, yet, once the case is properly made, centralisation can be compelling on the basis of exactly the same (assignment) principle.

2.4. The public economic functions of the EU

Inspired by the economic theory of federalism, the analysis can be taken one step further. Whereas the theory of economic integration is focussed on the removal of barriers to trade and other mobilities, and, where relevant, on the common regulation or policies that this would require, the economic theory of federalism originates from ‘public economics’, concerned with the economic functions of the state. The fundamental economic function of the state is to supply public goods. A pure public good (or service) is non-rival in consumption and non-excludable in supply. The latter property creates an incentive to free-ride on the suppliers and since everybody will do this, the good or service will not be supplied (cost cannot be recuperated from consumers who do not pay) or too little of it will be supplied. This can be resolved by assigning the state with the supply and give it the right to tax so as to cover the costs. Defense, domestic security and ensured access to justice are typical public goods. Until recently, these aspects were hardly or not associated with the process of European integration⁵. Of course this is different today and probably in the future. Moreover, there are public functions where positive externalities between regions or countries can be so strong – hence, the temptation to free ride, with undersupply as a result - that the difference with public goods is a matter of gradation. Basic research and knowledge ceration illustrate this point whilst network infrastructures exhibit somewhat similar characteristics.

Given the more advanced state of EU economic integration, as a result of deepening and widening of its scope, the economics of subsidiarity is becoming more and more a blend of economic integration analysis and public economics. In integration approaches the attention is focussed on the emergence and gradual completion of the internal market in goods, services, capital, labour and technology, and the manifold consequences this entails for the economic case of (further) centralisation (Pelkmans, 1982; Pelkmans, 1985; Pelkmans, 2001, ch. 4; see also Padoa Schioppa et al., 1987 for a systemic view as well as Sapir et al., 2003). In the tradition of public economics the internal market is largely, if not completely, taken for granted and attention is concentrated on the public functions the EU system should or should

⁵ One still wonders how credible the EDC proposal of 1953 actually was.

not fulfil at the central level, wholly or partly (CEPR, 1993; CEPR, 2003; Tabellini, 2002; Oates, 1999; Calmfors et al., 2003; Inman & Rubinfeld, 2002).

Since the Single Act, the internal market has been deepened and widened in scope so much that the EU began to assume elements of public functions which had not been seriously envisaged before. In particular, the initial role of the EU level was merely to establish the internal market and to make it function properly. In public economics this is called the "allocation function" of the state. With the deepening of the internal goods market via regulation and mutual recognition, the emergence of the internal market for services and the free movement of capital, the implications for the other two public economic functions of the state, namely "redistribution" and "macro-economic stabilisation", became ever more important. We shall discuss this in sections 4 and 5. Acknowledging that the Union has, by now, become concerned with some aspects of all three public economic functions, however, should not make us forget the four crucial differences with a federal country (see 2.2.). The EU is pre-federal. This state of the art has neither been altered by the Convention, nor by the final text of the Constitution.

2.5 The subsidiarity test

The Amsterdam Treaty restricts the application of subsidiarity to public economic functions where competences are concurrent (that is, shared between) at the Member States' and the EU levels. Article 5, EC prescribes:

In areas which do not fall within its exclusive competence, the Community shall take action, in accordance with the principle of subsidiarity, only if and in so far as the objectives of the proposed actions cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community. Any action by the Community shall not go beyond what is necessary to achieve the objectives of the Treaty.

Therefore, any action taken by the Community must fulfil two conditions. First, in areas of shared competence, the Community must demonstrate a need to act in common, as given by the existence of either economies of scale or cross-border externalities. If either of these conditions hold, non-cooperative policy making would be less efficient, or even detrimental, compared to cooperative policy making. This is broadly in line with the basic economics of subsidiarity. Second, any action must be proportional to the desired objective. Again, this is a logical corollary to the primacy of lower-tier government, where possible and efficient: no more than that which is necessary to attain the objective should be done at the 'central' level. Thus, when deciding whether to enact binding or non-binding measures, the EU level must justify the need for non-discrimination and legal certainty (both being indivisible in nature) before considering uniformity in measures. Even then, the EU should demonstrate the costs of differentiation before opting for a high degree of uniformity. The degree of binding could also increase, commensurate with the degree of complexity. If these justifications fail, EU regulations or directives would be disproportionate and only coordination, recommendations or consultation should be pursued. When binding measures (that is, legislation) are needed, framework directives should first be considered as they leave greater discretion to national and regional governments; if they would be inappropriate,

directives may still be preferable to EC regulations which are directly binding for all economic agents in the market. Where possible and efficient, Member States should play the primary role in policy implementation.⁶

One important criterion to decide upon the degree of centralisation, once the need-to-act-in-common test is passed, is credibility. If all Member States would voluntarily cooperate on a given policy issue, there would seem to be no need for centralisation. As game theory teaches, simple and repetitive cooperative games lead to ‘learning’ and may eventually result in efficient bargaining. But non-repetitive cooperation is often difficult to agree upon, for instance when the number of interested parties is large, the range of policy alternatives is wide, the problem is complex, and when (relative) gains and losses of players would be unevenly distributed. What really matters for economic agents in the market, however, is whether cooperation is credible, hence sustainable. Credibility of cooperation is low if information is highly imperfect or asymmetrically distributed, especially in complex policy areas, because this renders it impossible to monitor compliance. Credibility is also low when the incentives to cheat are strong and the ability or willingness to impose collective sanctions is perceived as minimal. If cooperation cannot come about, or it would not be credible, there is a case for centralisation.

The subsidiarity test can then derive assignments to the Union level as follows, in five steps:

- 1 Identify whether a measure falls within the area of shared competences (if exclusive to the EC, the treaty test does not apply);
- 2 Apply the criteria (scale and externalities, Art. 5, EC, and possibly other criteria) – this is the ‘need to act in common’ test;
- 3 Verify whether credible cooperation is feasible;
- 4 If 1 and 2 are confirmed, and 3 denied, then the assignment is to the Union level;
- 5 Define to what extent (proportionality) implementation, monitoring and enforcement should also be assigned to the EC level, or, indeed, can be assigned to the Member States, perhaps in a common framework.

The test would become fully general – that is, not bound by the treaty’s text – if the first step is ignored and all possible criteria are considered in the second step. Note also that step 3 may lead to cooperation at levels lower than the Union level, at EU level, or at continental or world level.

⁶ This interpretation is close to that actually proposed by the European Commission. See SEC (29) 1990, *The principle of subsidiarity*, 27 Oct 1992. A concise instruction to the various EU institutions, broadly reflecting those considerations, is found in the Protocol on the Application of the Principle of Subsidiarity and Proportionality attached to the Amsterdam Treaty.

2.6. Application of the test

Art. 5, EC and the Protocol on Subsidiarity and Proportionality as attached to the Amsterdam treaty⁷ add clarity without altering or adding much substance to the test. What matters is how to apply it, and perhaps even more how not to! This test is a *functional* one and can only be operational if goals and instruments, and indeed the legal basis for the assignment of powers to a higher level, are not themselves controversial. In some areas of today's European Union this condition is not fulfilled (e.g. foreign and security policy) and in some other cases the legal issue whether powers are shared or not cannot always be ascertained. However, these points ought not to be exaggerated, short of going counter to the very essence of subsidiarity itself. As soon as the subsidiarity test *itself* is politicised it becomes worthless and pointless. With political disagreement about goals or too great political sensitivities about central powers, the "better achievement" of certain policies is logically excluded, hence becomes irrelevant. In such cases, the refusal to consider centralisation is a pure political act – which might be legitimate, of course – but not a 'test'. The test is only useful if it is first accepted that it is a functional one which informs political decision-makers about costs and benefits as well as the implications of further (de)centralisation.

The test should also *not* be confused with the ultimate political decision to (de)centralise. Whereas the *test* is functional, the *decision* ought to be political, precisely because of the sensitivity at the level of local/regional preferences which are often only sufficiently revealed once clarity is provided about the repercussions. How difficult it is to properly "read" preferences of complex decisions with formidable repercussions has been underscored by the introduction of the single currency in Europe, no matter how carefully prepared and how much effort invested to reach the public and make citizens understand. Such political decisions have to be made by *elected* agents who are politically *accountable*. Only in such a way can subsidiarity decisions acquire political legitimacy. Decisions as important as monetary union are constitutional and require direct involvement of national parliaments or the voters. But many decisions about (de)centralisation do not have such a dramatic character and the subsidiarity test could be a highly useful *functional* underpinning of an ultimately *political* decision.

From an economic point of view the Protocol seems to have little added-value to art. 5, EC. Three guidelines in item (5) of the Protocol are not independent from each other. Indeed, the 'transnational aspects', 'conflicts with the requirements of the treaty' and significant 'damage to other Member States' interests are all manifestations of cross-border externalities. They will also, more often than not, overlap. In detailed methodologies or subsequent 'manuals', all possibilities must be covered which might render it necessary to verify whether the subtle differences between these three guidelines of item (5) of the Protocol matter in specific instances. However, this is not the object of the present paper which aims to explain the functional logic and exemplify its application, rather than elaborate a full legal, institutional

⁷ This is just as true for the text of art. I-11 sub 3 of the Constitution (not yet ratified). The two amendments of the present art. 5, EC, (namely, the explicit "in areas which do not fall within its exclusive competence" and the reference to the "regional and local level") are clarifications of the spirit of subsidiarity.

and technical analysis. The same goes for the simplified version of the protocol attached to the Constitution.⁸

It is perhaps instructive to provide five selective points on the application of the test. First, sometimes it is suggested that the uniformity of Community / Union law can serve as a reason to justify centralisation. One can view this uniformity as a public good once the case for it is made in a concrete instance. But it is not always necessary to uphold uniformity; one might needlessly suppress the satisfaction of local preferences when clinging to this notion. Hence, the principles of proportionality and differentiation have to be taken into account. Second, in trade policy or (e.g.) fishing rights the Union's bargaining power is of course boosted by centralisation. However, that is not an additional criterion because it amounts to a combination of (a threat of negative) externalities and scale. Whether such common power is welfare increasing is doubtful; it *is* for the Union but presumably at the expense of negotiating partners. If the Union's common power boils down to countervailing power (for example, vis a vis the US) this matters little as it will tend to offset their positioning but in the case of developing countries it is dubious. Third, the EU-25 is rich in its diversity of preferences. Nevertheless, selective issues might be supported by far-reaching homogeneity because of common elements in European culture or destiny or as a result of a long period of European integration which might prompt intergenerational convergence of preferences. Such degrees of homogeneity are hard to measure and the Euro-barometer is not suitable. Still, recent empirical work on apparent preferences (CEPR, 2003, pp. 25/6; Calmfors et al., 2003, pp. 85 – 88) shows remarkable similarities between the European peoples on key domains such as internal security and foreign policy⁹ which are not reflected in the state of European integration. Clearly, homogeneity of preferences has the effect of strongly reducing the costs of centralisation.

Fourth, subsidiarity in the context of this paper is a Union issue. But functionally, subsidiarity is not confined to the EU level. The need-to-act-in-common can be addressed in a smaller group (for example, adjacent countries; the Rhine Convention where the EU is represented via the Commission; the cleaning-up of the Mediterranean need not involve Finland or Ireland) or a larger association of states (whether the OSCE, the OECD, the signatories of the Kyoto protocol, or the European Space Agency, etc.). Such cooperative ventures do not move beyond the third step of the test. Finally, centralisation in this literature is a generic term that can be easily misunderstood, even when moving to step 4 in the EU. It does not necessarily refer to a strong variant of transferring certain powers to the Commission or, stronger still, an independent agency like the ECB. Centralisation has many intermediate options with different cost/benefit ratios. Like in any proper cost/benefit analysis, the alternative options have to be compared in the test. However, it can also refer to the mere prohibition of Member States to

⁸ Art. 5 of this Protocol combines what are currently items (5) and (9) of the Amsterdam version of the Protocol, in a much shorter text. Other than a reference to the implications for Member States in the case of a European framework law (a new legal instrument in the Constitution), the requirements are essentially the same. Moreover, the guidelines in the protocol, derived from Edinborough, remain 'acquis' in the event further precision might be needed.

⁹ However, it should be noted that the questions posed were highly general and of course, the answers were, for every individual, non committing.

act, in other words, what Jan Tinbergen (1954) used to call “negative integration”. Even taking merely the limited form of 'negative integration', centralisation may be felt by some at Laender or national level as a “regulatory gap “ or as excessive intrusion into their autonomy. It should be clear that, even when no explicit common regulation or common funding is at stake (no ‘positive integration’), there is merit in having careful regard to proportionality and differentiation so as to pre-empt avoidable suppression of preferences due to free movement or establishment.

3. Subsidiarity and EU efficiency

3.1 Liberalisation and centralisation

A closer study of how the EU was built up strongly suggests that more and deeper liberalisation tends to generate ever stronger functional pressures to centralise at least to some (though varying) degree. As noted there is little point in employing the principle of subsidiarity if there is only a minimal and exception-ridden willingness to accept selected economic mobilities, actual or potential, over frontiers within the integrating group. Despite the ambitions of the old EEC, the design flaws in the Rome treaty made it impossible to accomplish its own intermediate goals (like a true common market). The EEC was incapable of getting beyond what amounted to a “customs-union-plus” after 25 years (Pelkmans, 1985). The willingness to accept economic mobilities was simply too selective or conditional. The Single Act changed this radically (see Pelkmans, 1988 ; 1994). In turn, this set into motion a forceful process of deepening and widening of the internal market in the broad (i.e. economic) sense of the word, which is still not petered out. With a lag this has moved subsidiarity questions to the top of the EU agenda in all three public economic functions: efficiency, equity and macro-economic stabilisation. Hence, the Padoa-Schioppa report (1987), the deepening and widening in the Maastricht treaty and lingering ideas for selective centralisation in the recent Convention. However, the Convention has opted for a status-quo approach, with amendments in decision-making but hardly or not in the transfer of powers to the Union level.¹⁰

Looking back to two decades of follow-up to the Single Act, one observes that the internal goods market has largely been established, a significant achievement.¹¹ Besides the strong ‘negative integration’ that it entails, a range of centralising arrangements have been set up or strengthened. They proved acceptable precisely because of the willingness to live with and benefit from untrammelled goods mobilities.

¹⁰ In the public choice literature, a shift away from vetoes to QMV is nevertheless regarded with suspicion, as it might be in the interests of national governments and EU bodies alike to opt for greater ‘europeanisation’. Only direct involvement of national parliaments, having an interest to remain ‘closer to the voters’, would protect ‘subsidiarity’. The new text in the Constitution, in particular the involvement of national parliaments, goes some way to dispel these suspicions. See Vaubel, 1994a;1994b; 1995; 1997; Hosli, 1994; Buchwitz, 1998 and Dunleavy, 1997.

¹¹ This should not be interpreted to mean that the internal goods market cannot be further improved, for example, due to measures in other policy domains (e.g. tax issues ; patents). Also, the actual functioning of what is "acquis" leaves much to be desired (e.g mutual recognition).

The logic of subsidiarity - whether implicit or explicit - implies indeed that far-reaching liberalisation can require some degree of centralisation beyond mere 'negative integration' (Sun & Pelkmans, 1995-a). I shall mention three examples but many more can be found. The first example is concerned with the 'management' of 'free movement' of goods. The centralising element, indispensable for credibility, is the EU-priority over domestic legislative processes if mutual recognition is endangered. We refer to the 83/189 Ctee, meanwhile called the 98/34 Ctee (working on the so-called 'mutual information' directive 98/34), which is a low-key, yet remarkably effective body, probably doing more for the integrity of the internal goods market than many directives (for extensive assessment see Pelkmans, Vos & di Mauro, 2000). Member States are barred from proceeding with their domestic legislative processes of laws or decrees, which could imply regulatory/technical barriers to goods trade, following notification, and even (much) longer if new barriers are suspected to arise. The Ctee has proved capable of protecting mutual recognition, and thereby free movement as well, if not promoting it by ensuring equivalence or mutual recognition clauses and/or references to European standards in national laws.¹²

A second example is the complete turn-around in network industries on the basis of the very same article (Art. 86, EC) that served as the rationale for the now defunct Sacchi doctrine, which long prevented any move towards an internal market for network industries (Pelkmans, 2001b). Grossly simplifying the matter, the core test amounts to a severe look at proportionality: are exclusive rights for public utilities really 'necessary' (indispensable) for the entrusted tasks? If not, can forms be found which do not completely or not at all disrupt free movement, as well as free establishment and, as a corollary, insert some degree of competition? Once the turn-around is accepted, however, the ensuing liberalisation requires a lot of central legislation. Subsequently, autonomous agencies at EU level come in (e.g. rail safety; aircraft safety; air traffic control) and step-3-type credible cooperation between national regulators (possibly with the Commission as well) has to be practiced. Nowadays, examples of cooperation among national regulators include the ERG in telecoms and the CEER in electricity and gas. If not credible, step 4 would suggest an EU regulator.¹³ In the 2003 telecoms regime the Commission has obtained, after a battle between the EP and the Council, a kind of last-resort power if step-3 cooperation fails and the internal market or competition policy would suffer. The turn-around in the area of network markets has caused alarm in certain circles which assert that mobility and competition override their national preferences to 'protect' public services. In Amsterdam, in the Convention and in the subsequent IGC attempts were observed to create an explicit legal base for public service obligations. One interpretation of these pressures is an even greater regulatory centralisation in network markets.

¹² Note how important this 'low-key' centralisation has been, in that, every year in the EU-15, some 600-700 national draft laws first pass the Committee before domestic legislation (often with requested amendments) can proceed.

¹³ Of course, the Commission already has strong competition powers and thus could be seen as a partial regulator. See Pelkmans, 1998, for the detailed application of the subsidiarity test to the issue of a European regulator for telecoms.

A third example is in financial services and capital markets where a new wave of further liberalisation, standardisation and regulation between 2000 and 2005 has prompted a more centralising Lamfalussy method. And in the run-up to the Giovannini (2002) report, a former telecoms regulator, now chairman of the London Stock Exchange (Don Cruickshank, 2001) argued that clearing and settlement in securities markets have strong natural monopoly characteristics as indeed has been recognised in the US – this would imply further reaching centralisation as a corollary of deepening liberalisation.

3.2. Misusing ‘subsidiarity’ for labour markets

Interestingly, the internal market for labour has thus far failed to become a serious agenda issue. Here, subsidiarity is (mis)used as a fig leaf because cross-border labour mobility is *only* accepted *if* it is sure to remain trivial or residual. If free movement is systematically throttled, clearly, a functional subsidiarity test is thereby pre-empted, too. Whereas the host-country control principle is giving way in all other EU markets so as to allow free movement and competition, it is still prevailing for migrant labour in the EU. It is little realised why the host-country-control principal undermines free movement, without formally making it impossible. First, between EU countries with significant disparities in wage levels, host country control precludes wage competition, because the migrant from a low-wage EU country is not allowed to accept work below the host-country wage levels. In other words, the host country demand for migrant labour is no longer determined by wage differences, the crucial advantage of this category of migrants. As a result, the host country demand for (legal) migrant labour will reduce to a trickle, unless (and to the extent that) there are shortages in sectors or agglomerations. Second, even when wages differ little (say between the EU non-cohesion countries) host country control accentuates uncertainty about future rights, rules and customs because it discourages harmonisation, also when justified. But precisely due to the insistence on host country control, Member States also show a strong propensity to consider migrants as irritant special cases. Intra-EU migrants notice preciously little in national conduct that confirms art.10, EC on the Member States' Community loyalty. Migrants and frontier workers are insufficiently protected from the vagaries of national administrations, whether in fiscal, health, social, pensions, housing or other matters. Only the ECJ mitigated some of the consequences of ‘host country control’ for migrant workers. The Veil (1997) report on frontier workers showed how “unfree” the movement of workers still is. In 2001 (33 years after the free movement of workers had been declared!) the Commission issued a communication to finally begin to tackle the numerous barriers to cross-border labour mobility.¹⁴ Yet, the ‘posted workers’ directive 96/7 uses *EC* powers to protect *national* discretion in labour market regulation, which reveals the preference for fragmentation. How protectionist and arbitrary the posted-workers directive works out in actual practice, was demonstrated in Commission studies on the internal market for services.¹⁵ Given the manifest unwillingness to accept genuine free movement of labour, of course testing for subsidiarity becomes pointless. The upshot is that very little labour market regulation is harmonised,

¹⁴ COM (2001) 106 of 1 March 2001, New European Labour Markets, open to all, with access for all.

¹⁵ See in particular, COM(2002) 441 of 30 July 2002 on The state of the internal market for services.

except for health & safety in the workplace.¹⁶ Behind the fears one can discern an unwillingness of workers in A to compete with workers from B (certainly not on wages and secondary conditions) but also “Angst” about unpredictable effects on the finances of the “welfare state” and on those who (should) carry the burden of paying for it.¹⁷ This national protection of labour markets greatly enlarges the discretion for national decision makers, which, in turn, may well have the effect of further increasing the rigidities. In particular, host country control seems very hard to remove. Breaking these taboos would eventually have consequences for employment protection legislation (Young, 2003) at the EU level, presumably under some kind of regulated mutual recognition, as well as for selected EU rules for the welfare states or indeed an elementary EU welfare state itself. Nobody knows how far off this scenario is.

3.3. Resisting subsidiarity if it implies more centralisation

Subsidiarity can also be applied to a range of other aspects of the single market such as tax competition versus tax cooperation or approximation, and technology (here, in the sense of property rights such as the 42 years old fight about the EC patent) or. These two examples have long been under vetoes, expressing resistance against functional arguments in favour of more centralisation. As noted, a functional subsidiarity test is neutral between centralisation and decentralisation: it simply depends on the step-2 criteria and the credibility and effectiveness aspects. Vetoes create a strong bias towards unidirectional thinking: discretion for the Member States, even when the functional test is violated.

I shall only sketchily point out the main considerations. First, there is taxation. The VAT solutions (under the destination principle still, even after EC-1992) may pass the subsidiarity test (the first 4 steps) but not the proportionality test (see Verwaal & Cnossen, 2002). A shift to the origin principle would raise economic welfare. But it would require a common Clearing House (due to imbalances of revenue and, possibly, tax rate disparities). The objection that a Clearing House would be too involving and/or too risky for treasuries can be largely addressed by the Keen & Smith (1996) proposal for a common VAT rate for B2B transactions, while keeping fiscal sovereignty for the nationally distinct B2C rates. But the Member States are simply not interested. They would seem to regard the origin principle as de-facto too 'centralising', in the sense that functional pressures to approximate rates due to tax competition would be much stronger. National tax autonomy would be impaired. Moreover, the greater the tax rate disparities, the greater the role of the Clearing House, too. Even more fascinating is the query whether the EU should not be given the right to tax so as to facilitate least-cost solutions to thorny approximation problems (like energy taxation and capital earning taxes), while pre-empting or reducing distortive disparities in the single

¹⁶ Which is, actually, a response to *goods* market competition, not labour mobility. The idea behind it is that regulatory competition providing competitive advantages to firms in (say) country A, merely because of lowering safety requirements in factories or building sites (etc..), is considered unacceptable. At this general level of overall aims, the EU consensus is strong, hence, a series of directives prevent a ‘race to the bottom’. The subsidiarity test is therefore easily satisfied. However, there are indications, that these occupational health and safety rules have not been subjected to serious proportionality tests!

¹⁷ For a prominent example of this 'Angst', see Sinn & Ochel, 2003.

market. Or would mere approximation do (based on the “how” test)? The EU reached a solution on capital earnings and savings without introducing the EU right to tax, and without far-reaching harmonisation, but the act-in-common comprises several tax havens outside the EU and in the EU it requires a constitutional change (about bank secrecy) in e.g. Austria! For the CO₂ tax, long contested by business, the final solution is also very different: a trading system of emission rights, derived from the Kyoto obligations. In other words, it is good to realise that the alternative of EU taxation itself also implies complicated and intrusive solutions, and (for earnings on financial capital and savings) a degree of dependence on outside tax havens. Just rejecting the EU tax option does not solve anything and a functional subsidiarity and proportionality test can be revealing here.

As far as corporate taxation is concerned, the crux of the test will consist in a systematic consideration of both the costs and the benefits of tax competition, as well as both the costs and benefits of tax coordination (or harmonisation), while having due regard to both the tax base and the tax rates. Doing this properly will avoid the dysfunctional insistence on complete tax sovereignty, which, in a genuine, deep internal market, is inefficient.¹⁸ In corporate taxation, negative cross border externalities might cause a kind of 'race to the bottom', ending in inefficiently low levels of public goods or services (disregarding preferences). However, the empirical evidence for a revenue decline of company taxes in EU countries is thus far lacking. This, in turn, could be explained by higher profits (at least, during the 1990s) or by compensating lower rates by changes in the corporate tax base.

Indeed, it is hard to deny that the numerous disparities in the tax base tends to generate competitive distortions: the endless lobbying for tax breaks and the sensitivities in attracting FDI (played out by multinationals, of course) prompts almost permanent drift in the tax base, both nationally and in an internal market context. For these reasons, there is a *prima facie* case for a common tax base (or at least, for ruling out a range of 'harmful tax practices' linked to the base).¹⁹ The minimum rate argument, in particular now that the new Member States wish to use this instrument to attract FDI, is a more difficult matter. For instance, lower corporate rates (indeed, revenue) may also be compensated by a greater preference for indirect taxation, especially where tax collection is problematic (Fuest & Fuest, 2004). There is little doubt as well that the EU strongly favours catch-up growth in Central Europe and doing this via lower corporate rates is consistent with the aims of cohesion spending via the EU budget. Moreover, minimum tax rates may have the effect of protecting governments in continuing to spend without very effective controls by tax payers. The recent political protests of German and French ministers against low corporate tax rates in the new Member States might well express a desire to maintain this 'protection' because the budget pressures these countries are subject to have nothing to do with threats of a 'race to the bottom'. Therefore, it is advisable to retain significant degrees of tax competition, while excluding harmful practices. A workable compromise, combining steps 3 and 4 of the test, would be to harmonise the tax

¹⁸ For a thorough survey, see Zodrow, 2003; see also Devereux, Lockwood & Redoano, 2002 for strong empirical evidence of corporate tax competition on the basis of fiscal reaction functions ; a crucial source is also the elaborate treatment in COM (2001) 582 , in particular the accompanying Commission Staff paper SEC(2001)1681 of 23 Oct. 2001 on Company taxation in the internal market.

¹⁹ See Klemm, 2004 , for a careful verification.

base or important elements of it, supplemented by a low common minimum rate, above which effective tax (rate) competition can be kept alive (de Mooij, 2004).

Insofar as intellectual property rights (IPRs) are concerned, the unfortunate drafting of art. 295, EC has gradually been overcome for trademarks, copyright, neighbouring rights and designs. If it were not for art. 308, EC (formerly 235, EEC), the unconditional assignment of issues of "property" to Member States would have blocked a subsidiarity approach forever, despite the fact that IPRs can be used to make a mockery of the internal market and competition policy. In other words, the negative cross border externalities were serious and damaging indeed. The ECJ, when confronted with the absurd consequences of art. 295, EC, during the 1970s, developed the 'existence versus exercise doctrine', thereby reducing the fragmentation of the internal market.²⁰ Eventually, the case law and the EC-1992 programme reduced the resistance to Community trademarks and harmonised national trademarks, for example. In patents, however, the vested interests of a tiny group of specialists (wielding power because of the extreme asymmetries of information in the run-up to draft proposals) and the financial stakes of national patent offices have been able to frustrate the Europeanisation of patents for over four decades. It is little known that in 1962 a draft proposal on the Community patent almost passed Coreper. Early 2005 there is still no Community patent: the internal market remains fragmented to some extent and the scale argument is quite beneficial, too, knowing that the cost for patenting in the EU (i.e. for a range of key countries, at the very least) is easily five times as costly as in the US. Since 1973, the costs of filing, search and verification (a highly specialised and technical activity, hence a scale argument for a 'need-to-act-in-common') have been reduced significantly with the establishment of the European Patent Office. But all the EPO can do is to prepare filings in the countries indicated by the applicant, with the required technical dossiers added. The patent remains national and the laws are different; even if laws were identical, patents would still be locked into national jurisdiction, hence, frustrate the internal market. After decades of frustration, the conflict in Council no longer turns around the goals or the idea of a common patent but around highly parochial last-resort defences about translations into national languages. Without vetoes this point, in an era of globalisation and de-facto omnipresent application of technical English, would long have been resolved in a least-cost manner. The proportionality test fails hopelessly here.

3.4 The functional boundaries of national powers

The deepening and widening of European integration has also led to implications for national powers which are, and have long been, *uncontroversial* in subsidiarity terms. I shall discuss three important examples of policies under national competences. The issue here is not whether the assignment of such powers should be at the national level. This is widely regarded as justified. Rather, the issue is where the boundaries of such national competences are, whether these boundaries shift or ought to shift for various reasons and whether the subsidiarity test is a useful tool in identifying them. Given the functional nature of the test, what we are therefore interested in are the functional boundaries of national powers.

²⁰ See e.g. Govaere (1992) and any textbook on Community law.

I shall discuss one area, education, but several other ones would provide interesting material, too.²¹

Education is traditionally regarded as an archetypical case of national powers, indeed in some Member States, of regional powers. In some federal countries (e.g. the USA, Germany) no federal ministry of education even exists. In the EU this is by and large the case, too. Powers are clearly local, regional or national for elementary and secondary education. For higher education this is true as well but the close relation with voters, in terms of cultures, language and parental interests applies to a weaker extent, and the proliferation of cross-border studies, stimulated by increasing demand for it as well as by the pro-competitive response of many universities and other third level educational suppliers, seems to weaken the national embeddedness. The Constitution merely confirms the status quo in art. III-282 by ".encouraging cooperation between Member States and, if necessary, by supporting and complementing their action. It [the Union] shall fully respect the responsibility of the Member States for the content of teaching and the organisation of education systems and their cultural and linguistic diversity". The analogy with public health would seem to apply as indeed art. III – 278 (and today's art. 152, EC) suggests). However, the queries about the boundaries of national powers are much weaker in education than in health, for two reasons. First, there is no comparison with health in terms of a broad versus a narrow domain. There are only some minor free movement issues (e.g. recognition of diploma's of teachers) but next to no harmonisation and no EU agency for certification of whatever products or services (compare with the European Medicinal Agency for medicines) .Whereas public health is fully entangled in the internal markets for goods, and to a much more modest extent in services,²² the former simply does not apply to education except for textbooks and the like, which seem to present few problems. Second, free movement, let alone, competition aspects of the internal market for educational services are also relatively insignificant because commercial (that is, non-state financed) education other than specialised seminars and MBA offerings is still exceedingly rare in the Union. Apart from case law imposing non-discrimination in tuition and fees of universities for EU students, there is little pressure from what is a truncated internal market of third level educational services which might call into question the present boundaries of national powers.

Nevertheless, there are two driving forces of trends in higher education, which might eventually lead to a functionally justified shift in the boundaries of national powers. One is the intrusion of private finance into and commercialisation of third level education in Europe. If and to the extent that this trend is persistent, and in particular insofar as the offerings are in English (as is increasingly the case, and which implies a European demand and supply structure), an internal market perspective will be relevant. Once this happens, Member States will feel severely constrained in domestically regulating, supervising or co-financing such studies. It might perhaps lead to a demand for harmonisation of specific aspects, not envisaged under art. III-282 of the Constitution but presumably based on art. III-147 and/or

²¹ See Pelkmans, 2005, for illustrations in the areas of public health and the media.

²² See also the report of the High Level Group (2004).

III-173. In any event, it is bound to prompt a new look at the state aids regime which currently is irrelevant since an internal market has not yet emerged.

The second driving force consists in the crucial link between education and long-run economic growth, an EU objective ever since the Rome Treaty. Given deep and wide market integration, in the powerful framework of EMU and indeed (for many EU countries) a common currency, long run EU growth has the properties of a "club good" (a 'collective good' for a specific group) to some extent. What this means is that Member States' economic, including educational, policies pursued with a view to achieve higher economic growth in the long run, are subject to significant negative and positive cross-border externalities in the EU. The strong, long term link between education and growth is widely confirmed by economists (see Sapir et al, 2003 ; SER, 2004, ch.7; Aghion & Cohen, 2004). Since 2001 the EU ministers of education pursue a strategy in the framework of Lisbon emphasizing domestic reforms complemented by active stimuli from EU programmes promoting more cross-border exchanges in a range of initiatives. However, it turns out that the 'open method of co-ordination' is not effective in obtaining the results (in quality and speed) considered desirable.²³ The lack of progress has prompted more radical calls for a major increase in European funding for cross-border initiatives in the period 2007 – 2014 which would reach so many students (and professors and other teachers to some degree), and are bound to affect the interdependence between European universities and other third level suppliers so much, that one can begin to question whether the 'natural insulation' of national third level education remains applicable. This point is further strengthened by the (intergovernmental but partly market-driven) Bologna process of aligning bachelors and masters titles (and set – up of curricula) throughout Europe. Further cross-border linkages are amplified by the connection, at the highest levels of university education, with cross-border research programmes and the European Research Council (as proposed) as well as the emerging notion of "a Europe of Education and training", provisionally endorsed by the education ministers in February 2004. The point made here is not whether education should not remain a national competence. Rather, in the light of market and policy trends in third level education, it is whether and to what extent the boundaries of this national competence can functionally be argued to shift if it is to satisfy the subsidiarity test in the near future.

3.5. Towards Union public goods?

One could stretch the "allocation function" much further. One could discuss domains such as JHA, CFSP and defence. The latter two domains have a much less compelling link with the internal market. JHA emerges (mainly) from the abolition of internal frontiers and testifies how many different meanings are given to the notion of (the free movement of) persons. It also testifies how far one is forced to move in a cooperative if not centralising direction for a "zone of internal security" to be effective. As a (Union) public good, however, a half-baked approach is glaringly inconsistent and will incessantly be exploited by asylum seekers, economic immigrants and criminals. As a consequence, citizens will not find the weak,

²³ See the latest report on this strategy in COM (2003)685 of 11 November 2003, Education & training 2010, the success of the Lisbon strategy hinges on urgent reforms, Joint interim report of Council and Commission.

cooperative solutions credible [remember the wording of step 3 of the test] and this will continue to exert pressures for more efficient and effective solutions. These have to be assessed in detail but inevitably will cause a significant increase in the now trivial JHA Union budget, and prompt, in part, more centralising solutions. A manifestation of this trend is the shift to the Community method for JHA in the Constitution.

CFSP is typically treated by economists as a Union public good par excellence. Analytically, this may be correct but the question is whether this analytical observation brings us any further. The argument for a credible CFSP does *not* hinge on the discipline of cross-border mobilities in the internal market, one of the two standard criteria for the subsidiarity test. Instead, it is based on convictions that the Union as a Community of “values” should provide itself with the means to defend and promote these values internally and externally. At this level of abstraction, the argument can be extended to common defence functions of the Union. A related point consists of the discrepancy between the economic might of the Union and its political frailty. Only a properly organised and to some extent centralised CFSP could re-equilibrate this imbalance. Since this reasoning only has a remote link with the internal market and is primarily concerned with the willingness to produce and enjoy the public good in common, the cardinal issue here are *preferences* and their translation into the public policies and positioning in the CFSP as well as the effective political accountability towards the citizens. At a general level of Eurobarometer questions, European citizens are indeed massively in favour of a more European approach in foreign and security policy, and, to a lesser extent and with a sharper differentiation between countries, in defence as well. However, preference revelation in specific issues and the permanent process of political accountability are highly sensitive in these areas, also inside the composing nation-states of the Union. It is for these important reasons that the simplistic and far too general public goods approach having been advocated in recent economic papers and reports (e.g. CEPR, 2003; Tabellini, 2002; etc.) adds no value or insight. Where the link with the internal market is direct (e.g. the scale and externalities arguments are more compelling in joint R & D in military technology, standardisation between NATO and the EU rapid joint force, and joint procurement) a subsidiarity test might be helpful to overcome petty resistance.

4. Subsidiarity and EU equity

The economics of (fiscal) federalism has generated a body of theory showing that the pursuit of equity in the presence of high actual or potential mobility of taxable persons or firms between states in a Union has to be largely addressed at the Union level. Only at the Union level can the negative externalities be internalised (no race to the bottom) (see Oates (1999)). Social charges and taxation of earnings might differ between Member States and, if one would assume costless mobility of persons and companies, it is possible to envisage a theoretical scenario where such disparities in fiscal burdens would lead the richer persons and the profitable firms to move to low-tax/low social charges states. In other words, under such extreme assumptions the tax base of a country would itself become mobile and a country could not pursue independent equity objectives. At this level of pure theory, there are two solutions: either one assumes perfect and stable interstate coordination in equity – but the

temptation for states to deviate would be very strong – or equity and the way of financing it would have to be centralised, including an agreed formulae of distributing the revenue among the states. Of course, in reality, cross-border mobility is far from costless in pecuniary and human terms, even in the longer run, and therefore this scenario is far-fetched. But a weak version of it, over longer periods of time, might have some validity for the more mobile elements of the tax base (not to speak of purely financial capital). As noted, workers in Europe are severely hindered to move across borders, but it has to be recognised that they are not even very mobile inside countries (at least, given the social protection they enjoy). But companies are more mobile. Especially multinationals can be highly flexible at the margin (the extra direct investment) and have to be rational in terms of costs in the long run (relocation, despite sunk costs). Insofar as equity is supported by company taxation, Member States are therefore already constrained. However, for personal income taxation the tax base is essentially immobile and the rules of the welfare states are such – including the links with the labour markets – that it remains carefully protected (see 3.2). Equity in Europe is thus a relatively effective policy at the decentralised level. The Union has no overall equity assignments and this seems to be correct from a subsidiarity point of view. Nonetheless, there is one major caveat: it does mean that *one first accepts the fragmentation* of the internal market for labour! Once the fragmentation erodes – that is, the more cross-border labour movement is facilitated and the more migrants respond to such incentives -, some moderate pressures (or disciplines) would eventually arise and prompt the coordination of equity or even the build-up of a two-tier, quasi-federal system.

The question may arise whether it is correct to state that the Union does not have any equity objectives and instruments at all? One is tempted to respond that “cohesion” represents an equity aim. This is doubtful, however. At the very least it is a mixed efficiency/equity game (see below). Furthermore, the CAP has explicit redistributive goals, protecting farmers’ incomes, but this is accomplished via inefficient interventions in the internal market under very strong political pressures. This violates the notion of a ‘functional’ approach to subsidiarity, adopted here. Therefore, it is better discussed in section 6 where we drop the notion of benevolent governments merely pursuing the European public interest. Finally, one could situate the permanent debate about a more Social Europe under this heading. Looking through the subsidiarity glass to this excessively vague debate, one cannot but get the impression that a game of (warm) words is played without much of an operational meaning. Social Europe is continuously reaffirmed in dialogues, charters, resolutions, objectives and declarations or, to some extent even in the Lisbon process, without much interest or willingness to add the means to the avowed aims. This is consistent with the state of the art as analysed before. Indeed, how can Social Europe move beyond a general communality of aims if the free movement of workers cannot even be resolved and mutual recognition not even applied? The response in the Convention confirmed this in a striking manner: working group 11 (on Social Europe) explicitly preferred the status quo but insisted on the insertion of several even more nebulous ‘warm’ words at the declaratory level in the draft constitution.²⁴

²⁴ See CONV 516/03 of 30 Jan. 2003, Final report of Working Group XI on Social Europe.

Economic and social cohesion might perhaps seem to be an exception to the lack of broad EU equity concerns. But a closer look does not affirm that. Social cohesion, an ill-defined term anyway, is usually contrasted with social exclusion and this is weakly addressed in the “open method of coordination” (OMC), a soft form of step 3. It does not imply any Union competence. Economic cohesion is routinely defined as the reduction of disparities of real income per head between regions or countries of the EU over time. It is pursued in three ways: via the convergent impact of the growth effects of the internal market, via the removal of anti-cohesion aspects of EU policies (notably, the CAP) and via budgetary transfers under strict conditionality. Only the latter look like an equity policy, although a weak one because it relies on the weakest federalist instrument, namely, specific purpose grants.²⁵ However, the link with “solidarity” in the ordinary sense of equity motivations is in doubt here. In fact, the aim of cohesion transfers (via the various funds) is “catch-up growth” which is to say that the solidarity is *temporary*. The real aim is higher *efficiency* combined with infrastructure capacity building, yielding such a high growth rate of less prosperous regions or countries that cohesion policy can eventually be phased out. National equity policies are *forever*, not temporary and the handicapped, the old, the sick and the very poor are not expected to disappear.

5. Subsidiarity and macro-economic stability

For a long time macro-economic *instability* at the Member State level was the achille heel of the internal market. The EEC treaty was designed with a series of crippling conditionalities, from the conditional liberalisation of financial services, via the even more conditional liberalisation of (financial) capital²⁶ littered with safeguards, to the infamous art.s 108 and 109, EEC, the safeguards to protect a currency with disruptive means in the event of macro-economic instability. Very weak instances of step 3 macro-economic cooperation were envisaged in the Rome treaty but, with escape routes and no sanctions, it was grossly insufficient. Nowadays this is history and, interestingly enough, also for the non-eurozone countries. Section 5.1 is a brief reminder of how the making of EMU can be conceived in terms of subsidiarity. Subsequently, today’s EMU is characterised as a unique mix of centralisation and decentralisation. Since the centralised part of EMU is long completed, the lingering queries are concerned with the decentralised aspects, that is, the budgetary disciplines in the treaty and the Stability & Growth Pact. Is there too much EU discipline or too little? Finally, the potential third pillar of macro-economic stability in EMU is the EU budget and also this item can be discussed in terms of subsidiarity.

5.1. Subsidiarity and the making of EMU

The completion of the internal market necessitated first that these crippling conditionalities would be overcome in a way credible for markets. In turn, this implied proper “sequencing” of the liberalisation as well. EC-1992 did the latter as it designed a revolutionary approach to

²⁵ See Walsh, 1993.

²⁶ In fact, art. 67, EEC spoke of ‘endeavour’.

financial services liberalisation (e.g. home country control, mutual recognition and minimum approximation) from the outset. The abolition of exchange controls followed suit without prompting macro-economic instability in the EMS. The third step – credible macro-economic coordination pre-empting currency crises – could then be seriously addressed. However, for such a step 3 solution, no matter how tight the rules and how elaborate the various (cooperative) financing and intervention mechanisms, the EMS proved to be a rough learning experience. It became clear that national macro-economic thinking had to converge first in Europe and during the 1980's this exactly happened. Next, markets had to be convinced by hard evidence that policy makers were prepared to obtain price stability even by painful disinflation. Once this became accepted and given downward convergence of inflation rates as well as convergent macro-economic thinking, it became attractive to “lock in “ stable money and sound public finance in a more centralised framework. This was especially true because, in the presence of free and potentially huge capital mobility and a grid of rigid exchange rates, the autonomy of national monetary policy (and thereby exchange rate policy) had diminished greatly. It is this compelling logic which explains the relative ease and speed of designing the EMU part of the Maastricht treaty.

It would be too simplistic to say that the credible completion of the internal market unleashed an unstoppable dynamics towards EMU. But the incentives to go this route became very strong and the countries that have not joined are nonetheless deeply influenced by it. Short of joining the eurozone the ‘outs’ subscribe to the same basic principles and several similar obligations. Indeed, in the Danish case one wonders what the economic difference is if one does not join the euro but is gearing every relevant policy instrument to the maintenance of a perfectly stable krone/euro ratio so as to keep the interest premium as low as possible²⁷. In fact Denmark has made two choices, both rejected by eurozone countries: it does not join the third stage of EMU (including its budgetary disciplines), yet it keeps ‘fixed’ exchange rates with the euro in ERM-II. This combination implies a de-facto euro membership and the markets’ conviction about Danish policy credibility determines the ‘price’ (the premium) it pays. In addition, Denmark incurs conversion costs. The countries moving to stage III of EMU could have kept ‘irrevocably fixed exchange rates’, too, but this entails residual conversion costs and significantly reduces the subsidiarity case for a central monetary policy (see Gros & Thygesen, 1998, for a revealing analysis of this point). Hence, the EU switched to a fully central solution, a single currency. Also, the institutional approach has been centralising by making the ECB the first truly independent agency of the Union. The key argument here is that monetary policy is indivisible. It is only upon a closer look that one discovers a number of less central elements, linked to the national central banks (cf. Bini Smaghi & Gros, 2000). The recent reform of the ECB decision making is yet another shift towards further centralisation rationalised by the credibility of price stability.²⁸

²⁷ European Central Bank, Annual Report 2002, pp.92-95, and Annual Report 2003, pp. 65-67.

²⁸ Gros, 2003.

5.2. How decentralised is fiscal policy in EMU ?

It is often asserted that EMU has centralised monetary policy besides decentralised budgetary policy. However, a too literal reading of this statement is probably inconsistent with a subsidiarity perspective and would be dysfunctional. The statement is correct in that EMU, unlike many other monetary unions, has no central budget of any significance (see 5.4). But how decentralised is *national* budgetary policy ? The fiscal side is somewhat constrained by prevailing tax harmonisation, mainly of indirect taxes, and the Code of Conduct on corporate taxation. The treaty prohibits excessive deficits and pre-empts any ‘bail-out’ in case of extreme debt. The Stability & Growth Pact further tightens the discipline by prescribing a balanced budget over the medium run and can apply a staggered financial sanctions regime following a lack of compliance. Future claims on the national budget, in particular pensions, are nowadays subject to ‘open coordination’. The conclusion is that, for the so-called monetary/fiscal policy mix in the eurozone not to become adverse, the EU constraints on decentralised i.e. national budget policy are considerable.

A fortiori this is true if the juxtaposition is between centralised monetary policy and decentralised *economic* policy. Remember that art.s 98 and 99, EC employ the term ‘economic policy’. National economic policy, other than budgetary, is much more constrained by the internal market, and the related approximation and common policies, than the word ‘decentralised’ would seem to suggest. Essentially, the budgetary and other economic policies represent the E of EMU and unless economic policies are genuinely local/national in effect, the economic union governs them by and large. The E of EMU is too often disregarded as the foundation of the single currency. For it to serve this function well one should have regard not only to the EMU part of the treaty but to almost the entire economic domain in the treaty (WRR, 2003, ch. 3). How decentralised that is can be a matter of debate but it is certainly not the case that Member States have almost full discretion, far from it. The somewhat soft coordination in the Broad Economic Policy Guidelines process, based on art. 99, EC, has to be understood against the backdrop of the entire structure of the *acquis*.

5.3. The Pact: more or less of it?

The lively debate about the merits and shortcomings of the budgetary disciplines (here called “the Pact”, for short) is in essence an exercise in applying subsidiarity. Although a range of technical economic proposals seems to make this an expert discussion (see e.g. Buti, Eijffinger & Franco, 2003 for a survey), the heart of the matter is that budgetary *integration* rather than *coordination* would require a central budget with macro-economic policy significance. This is so far outside the current set of preferences in Europe that it is not an option in the foreseeable future, or perhaps never. Thus, budgetary coordination brings the Union, or at least “Euroland”, in the twilight zone. On the one hand, there is resistance because the Pact is seen as excessively centralist in the sense that it might constrain national economic policy autonomy, which is needed as an offset of the ‘one-size-fits-all’ approach of centralist monetary policy. This perspective should not be regarded as a mere short-run political convenience of political leaders feeling uncomfortable with the disciplines, reducing the probability of their re-election. Clearly, that might be the case but there is more. Especially once the debt ratio is under control (say, below 50 % or so) the faithful application

of the Pact forever into the future will have rather curious consequences which are hard to defend economically (like zero debt in the long run). On the other hand, the Pact is viewed as insufficient in several ways, including the credibility of the sanctions (remember that credibility is crucial for step 3 to work), a number of technical features of the Pact (e.g. aspects of incorporating the medium run, the mistaken emphasis on deficits rather than the debt ratio, etc.) and the credibility of the joint surveillance as it is dominated by the players themselves. In this already complex twilight zone, the political sensitivity is raised greatly by the simple fact that national budgetary debates, which always attract great attention in domestic politics, are now partly europeanised. The politicisation raises the problematic issue of *accountability* in the European arena since the EcFin Council, let alone the Eurogroup, as such is not politically accountable. What might help to reduce such politicisation, hence facilitates the political life of Finance ministers, is to regard the Pact as *rule-based* coordination, limiting national discretion and more than marginal deviation signaling non-compliance. With more centralising budget options excluded for political and accountability reasons, the query is whether this second-best solution is stable in the long run.

5.4. The Union budget

Despite its absolute size the Union budget is not a macro-economic policy budget in any serious sense of the word. It is not at all comparable in relative size to the budget of the Member States (2.3 % of the aggregate of the national budgets of the EU), its main components are more or less fixed (CAP and cohesion take nearly 85 %), it can not run deficits by law and is not funded by European taxes or by flexible forms of automatic revenue. Moreover, one could argue that, in the long run, the EU budget will “dry up” as it were. The CAP is gradually moving away from price support to income support, itself subject to a mildly digressive trend. One might also question whether this shift in instruments need not be accompanied by a review based on subsidiarity (see section 6). Indeed, in scenarios up to 2013 inclusive, the share of the CAP in the EU budget is likely to reduce from the current 45 % to 37 – 38 %; with a further review it is likely to fall absolutely. In the case of cohesion the story is similar. In 25 years from today it seems reasonable to expect that catch-up growth will have produced convergence, at least among today’s Member States, to such a degree that the budgetary outlays for it will shrink. In other words, the long run perspective of the EU budget is one of further reduction to trivial size, if current policy preferences of Member States are continued. True, one could accept functional arguments, consistent with the subsidiarity test, to replace (some of the) central cohesion and CAP spending by common expenditures on research and e.g. TENs (see Sapir et al., 2003, and SER, 2004).

However, if such new common spending remains limited, the upshot would be a monetary union only trivial central expenditure and this would be unique. For the moment, however, it is imperative to question the byzantine way of the Union to collect revenue for current expenditures. It is probable that the revenue side artificially suppresses a rational use of joint financing of Union policies, because EU revenues are systematically regarded in terms of net paying positions of Member States. This can only be removed by reducing redistributive policies (CAP & cohesion) on the one hand, and by reforming the instruments of revenue collection on the other hand. Nonetheless, it would be an illusion, even if such reforms were

to be successful, to believe that this could soon lead to a central budget with macro-economic significance. Indeed, a more rational revenue side of the EU budget is unlikely to be acceptable to Member States, unless the expenditure ceilings remain under veto. The Constitution has indeed not changed the heavy (in fact, constitutional) procedures for 'own resources' decisions.

6. The political economy of subsidiarity

Having illustrated how to 'test for subsidiarity' functionally over a wide spectrum of EU issues, it is critical to consider again the underlying assumptions of the functional subsidiarity test. Three points will be mentioned. First, it is not realistic to assume that governments are always benevolent in the sense that they are purely and solely pursuing the (European) public interest. There are two variants of such government failures (Calmfors et al., 2003): the Leviathan approach (i.e. government aims to confiscate the wealth of its citizens, discussed in 6.1.) and different degrees of capturing political decision-makers (private interests become predominant, discussed in 6.2). In 6.3, we discuss two additional problems with the underlying assumptions.

6.1. Decentralisation for accountability and responsiveness

The Leviathan idea has given rise to two strands in the economic literature which favour decentralisation. One is Seabright's (1996) model emphasizing differences in accountability. Decentralisation is shown to increase the opportunity for citizens to control policy-makers and thereby reducing the probability that (their) government may act 'Leviathan'.²⁹ The other strand is based on Tiebout's (1956) model of cross-border mobility of consumer-voters. This strand has gradually developed a large literature about, first, fiscal competition and, later, regulatory or policy competition between states in a union. Such thinking amounts to decentralisation. A few quotes from today's debate illustrate the inferences from this literature. As Calmfors et al., 2003, (p. 80) note "...intergovernmental competition for mobile resources can provide limits to Leviathan governmental behaviour". In CEPR, 2003, p. 8 it is said that "...arrangements that promote competition between localities may be helpful, in so far as they increase the exit options available to citizens (the opportunity to move elsewhere) and force local politicians to pay more attention to economic effectiveness". This statement is a little curious in that interjurisdictional competition has the effect of *reducing* the attractiveness of exit, precisely because attention *is* paid to alternatives elsewhere. Also Qian & Weingast (1997, p. 88) conclude that "... competition among jurisdictions forces governments to represent citizen interests".³⁰

²⁹ An original model, with a principal/agent set up and based on the theory of 'incomplete contracts', there are nevertheless considerable problems with Seabright's approach. Apart from restrictive assumptions, the greatest problem is that the model can only handle positive spill-overs and not negative ones, in actual practice the most important ones in European integration.

³⁰ See also Sinn (2003) and some essays in Esty & Geradin, ed.s, 2001. For a critical review, see Sun & Pelkmans, 1995-b.

There is certainly merit in the general idea behind these writings. It should be noted, however, that interjurisdictional competition only works if cross-border mobilities are allowed and (potentially) strong. These conditions do not apply in Europe for labour. As to firms, most of them are not footloose but have high sunk costs (both tangible and intangible) and even if they are mobile at the margin (e.g. new direct investment), the determinants of this mobility may well be dominated by the fundamental determinants of location (e.g. comparative advantage) rather than differences in tax or policy.

And national politicians also appear to be inert in these reasonings, surely an odd assumption if one studies actual EU practice. Alarmed by the secular rise in labour taxes as well as some erosion in corporate taxation revenue (especially for financial holdings of multinationals) the EU began to accept a need-to-act-in-common in corporate taxation. The 1997 Code of Conduct has forced several EU countries (mainly, Ireland, the Netherlands, Belgium and France) to scrap or amend 'harmful' measures of tax competition, a typical step 3 form of coordination. Moreover, on income from savings and capital at long last, much greater determination has recently been shown by EU countries and the end of this tax evasion may well be accomplished by the combination of step 3 (detailed mutual information) and step 4 (a directive) measures [see, *infra*, 3.2]. With respect to policy or regulatory competition in the EU, only few results can be observed³¹. At best the 'open coordination' method in the Cardiff, Luxembourg and Lisbon processes might raise awareness somewhat but it is most doubtful whether, in Europe, the responsiveness to differences of this kind is expressed in additional mobilities (exit) rather than voice.³²

6.2. Decentralisation as a remedy against 'capture'

As noted, the other government failure is 'capture'. Of course, capture plays a role at both government tiers in the Union. If pressures are strong enough at the national level and the relevant private interests in Member States have sufficiently in common, the EU level political decision-making risks to be hijacked by coordinated private interests. In that case, the question arises whether the centralisation so decided is consistent with subsidiarity. The CAP is by far the most important instance. As far as price levels and the targeted farmer's income are concerned, the CAP has always been centralist. The logic is understandable: once national policies are very interventionist it will be impossible to accomplish an agricultural customs union, with free movement, unless the political imperative of interventionism is satisfied at the Union level. However, this does *not* imply that such a logic translates into a justification in terms of subsidiarity, least of all for step 5 (proportionality). Today, with the shift from price to income support, the latter more and more 'decoupled' from production, the case for centralisation is far weaker still. Since income is nationally differentiated in the Union and, in any event, not a cause for a failure of the internal market of agro-goods to work

³¹ See e.g. Sun & Pelkmans, 1995-b. A recent example might develop in company law in the EU Member States. See Heine, 2003 and Hertig & McCahery, 2003

³² In, fact, the national governments responses to 'open coordination' have remained superficial at best. See e.g. Pelkmans & Casey (2004). This means that exit options do not represent any disciplining or stimulating effect on Member States.

well, income support should be drastically decentralised, under a strict EU regime of common rules and active supervision.

But it would be wrong to generalise from the CAP example that national interventionism always prompts centralisation. One can observe two contrasting experiences in this respect : fragmentation but also ingenious solutions to liberalisation. As to fragmentation, for example, in five decades of European integration there has never been an internal market for coal, as a result of extreme national interventionism with serious negative cross-border externalities. And the history of shipbuilding – already an explicit exception in the Rome treaty - hardly makes for better reading. Thus, in coal and shipbuilding, national interventionism did not lead to centralisation, but to fragmentation of what could have been an internal market. yet, there have been contrasting developments, too. In numerous instances national interventionism has neither led to (permanent) obstruction of the internal market nor to centralisation but to sophisticated solutions in the EU interest such as mutual recognition, mild approximation or indeed to a soft death of intervention over time. Perhaps the most interesting lesson of European integration is precisely found there: once the free movements are carved in stone, as they are in European law, and enforced credibly, countries have strong incentives to scrutinise their own as well as one's partners' laws, with the result that countless provisions, originally driven by private interests, do not survive in the market or in harmonisation. This process is presumably stimulated by market pressures, reminiscent of regulatory competition (given mutual recognition). Nevertheless, only a minor part of this process takes place via complaints or litigation. Many problems end up in European decision-making processes in which specific national interests, driven by 'capture', have little chance of success. Note that the mutual recognition case law of the ECJ (largely) closes off the option of upholding national barriers to imports from the Union. The primacy of mutual recognition is too often neglected when discussing subsidiarity and centralisation. Mutual recognition constitutes an explicit *denial* of centralisation as no EU directive is needed. In fact, the EU has engineered a very deep form of market integration without going very far in terms of centralisation in most cases. Indeed, 'voice' in the Union should often be understood as coming from other Member States and/or EU institutions (in contrast with the Tiebout-based literature in which it comes from mobile voters) and they attach little significance to the domestic political influence of a certain pressure group in one Member State. Based on QMV, national rules or exceptions resulting from capture are nowadays routinely overruled or ignored in the approximation process in Brussels. The upshot is that a negative and (modest) positive integration often substitutes effectively for the practical weakness of 'exit' as an alternative option.

6.3. Can functionalism avoid politicisation?

The second assumption underlying the functional subsidiarity test is neutrality between the two possible outcomes of a test: centralisation or decentralisation. The political sensitivity to the former can be much greater than the latter. The EU is far from being a federal model, as noted, and the Convention has been a unique occasion to verify national preferences in this respect in many political groupings. The conclusion from the Convention is crystal-clear: the draft constitution was essentially and consciously codifying the status-quo, while improving somewhat on effectiveness, transparency and democracy. New transfers of powers were not

envisaged. Can one argue that greater effectiveness of using already transferred powers is 'federalising' the Union once again a little more? Even if one takes such an extreme position, it is worth noting that the IGC has certainly reduced several instances of easier decision-making in the final text of the Constitution. All in all, EU "federation" has not come any nearer. Not only was the word "federal" in the draft pre-amble scrapped without much ado, the "constitution" is still a "treaty", nothing close to a federal government was even suggested, no social harmonisation was desired (let alone, a European welfare state, even modestly), no legal basis for the EU right to tax was introduced, any increase of revenue above 1.27 % of EU GNP (sic !) will have to be ratified by Member States, no common army has come in sight (although closer cooperation would be facilitated), and an exit (secession) clause was introduced, even though the adoption and ratification of any amendment of the new treaty has remained fully within the traditions of classical international law.

At the same time, the Convention has revealed that, in a number of areas, the interest in limited and selective forms of further centralisation differs significantly between the 25 Member States. This diversity in accepting centralisation makes it more problematic to employ consistently a subsidiarity test on a purely functional basis. It runs the risk of being politicised and discredited, no matter how detached the work is done. It is good to realise why: a professional, functional test is regarded as a menace by those ones most sensitive to any further centralisation. However, it is one thing to have all the pro's and con's laid out professionally, and quite another to take the political decision, helped by the analysis and the test. It is the latter where political 'ownership' and accountability is found, and that does not and should not change with functional testing for subsidiarity.

7. Conclusions

A functional approach to subsidiarity in the framework of (European) representative democracy seeks to find the optimal assignment of regulatory or policy competences to the various tiers of government. In the final analysis, this is about structures facilitating the highest possible welfare in the Union, in the fundamental sense that preferences and needs are best satisfied. What is required for such an analysis is no less than a systematic cost/ benefits framework to assess the (de)merits of (de)centralisation in the EU. Many of the issues may appear economic in nature, mainly because the Union today is still overwhelmingly concerned with economic objectives and means, including the internal market in the wide sense of the term and the eurozone. But both for economic and non-economic issues, preferences might or might not be biased against a strong degree of centralisation, even if a pure calculus might show foregone benefits by taking this stance. The entire point of a subsidiarity test is not to influence such preferences but merely and solely to clarify and make transparent what the costs and benefits are (quantitative or qualitative but as completely as possible) of proposed (de)centralisation.

A subsidiarity test will have to be elaborated and utilised in a much more convincing way than hitherto in the Brussels circuit or indeed anywhere in the Union if the prominence of the revised Protocol on Subsidiarity in the new Constitution is to be done justice. One can continue to assert that subsidiarity is "political" but this says little more than that the ultimate decision is up to politically accountable legislators. Indeed, it is and it ought to be. Yet, that point does not bring those politicians any further. Imagine 25 national parliaments getting no more than 6 weeks to assess often complex draft directives, come to a negative political decision and then attempt to make the other parliaments understand how and on the basis of what analysis they came to their decision so that eventually a one-third threshold can be reached. This will at the very least require a culture of thinking in terms of the substance of subsidiarity, and not merely procedural or "political". And that culture of thinking in terms of subsidiarity best passes through a functional stage – the subsidiarity test – as a basis for all the national parliaments and for the Commission in an earlier step, before a well-informed political judgement is cast by those politically accountable.

The present paper has attempted to show that a functional perspective, disciplined by a subsidiarity test as proposed, would be a fruitful route to go. The many examples it provides hopefully give a flavour, or more than that, of how this thinking could be applied in the Union and where the subsidiarity 'flag' is misused to hide plain unwillingness about cross-border mobilities or about the acceptance of the consequences for national policies. In principle, there is nothing wrong with national resistance against "more Europe" if this truly expresses the domestic voters' preferences. But it pollutes the subsidiarity debate if one hides behind a functional principle to 'justify' a plain political refusal. There is also a strong current among politicians and, at times, in the press and elsewhere, to regard subsidiarity as a one-way principle: 'more subsidiarity' would mean 'a return of powers to the Member States'. The paper clarifies that such soundbites make no sense at all. There is no such thing as 'more subsidiarity' and rigorous testing for subsidiarity is completely neutral between upward or downward assignments of powers. This is precisely the very outcome of the test. Subsidiarity is a two-way principle.

Finally, I venture some hope that the presentation here is not only or not even primarily read by economists but first of all by lawyers and political scientists. Once it would come to practical applications of the subsidiarity test, say, for national parliaments, only multi-disciplinary teams could supply the legislators with the full analysis that will be required.

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