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What Competences for the EU? Towards a European Version of Fiscal Federalism

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Abstract

The issue of *What the EU Should Do*, or what should be the competences of the European Union, is gaining more relevance with the increasing level of EU integration. The academic analysis on the competences of the EU has so far not fully answered this question. The political science literature has focused on the "democratic deficit" and lack of legitimacy of the EU, assuming that solving these problems would naturally lead to the correct allocation of competences. The economic literature on the contrary focuses on fiscal federalism, analysing which policies can be done more efficiently at the EU level, but ignoring whether it is seen as legitimate to reduce national sovereignty on those policies. This paper argues that only a combination of the two approaches can lead to useful results. It adapts the theory of fiscal federalism to the EU, by incorporating the concept of *legitimacy* into the analysis. Legitimacy is assessed through three factors proposed by the literature: normative justifiability, popular acceptability and accountability. The analysis is applied to different areas of policymaking. Results show that this modified form of fiscal federalism leads to more complete and realistic insights.

Keywords: European Union, EU competences, fiscal federalism, legitimacy

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1. INTRODUCTION

The recent agreement on the EU Treaty of Lisbon appeared to solve the immediate crisis caused by the rejection of the Constitutional Treaty in the 2005 referenda. However, it did not address what was arguably the underlying problem: the EU has entered an “identity crisis”, as there is no agreement on what it should do. The academic literature on the competences of the EU has so far not fully answered this question. The political science literature has focused almost exclusively on the "democratic deficit" and lack of legitimacy of the EU, assuming that solving these problems would naturally lead to the correct allocation of competences. However, that would not necessarily be the case, as those are two different issues that need to be analyzed separately. Moreover, it is difficult to find the appropriate democratic setting for the EU without first knowing what its function should be.

On the contrary, the economic literature has focused only on fiscal federalism, the field of economics that studies which policies should be allocated to a more centralised level of government and which should be done at a decentralised level. These theories originated in the United States, but, as the integration of the European Union progressed, scholars began to apply them to the EU. However, the theories of fiscal federalism were designed to be applied to the US, which is a single country, as opposed to the EU, which is an economic and political union between sovereign countries. Therefore, although fiscal federalism provides useful insights to the analysis of the EU, the fact that the theories are most suited to one single country creates problems to the analysis, as several authors have admitted. For example, Oates (2002) comments that *"much of the literature, especially the part addressing the assignment of functions, has been developed in the context of the modern nation-state. (...) As such, it doesn't seem to fit very well the cases of emerging «confederations» such as the European Union"*. Ackrill (2003) also argues that *"in the context of the European Union, this [fiscal federalism's] traditional paradigm is not only inadequate but confused, leading to a lack of clarity in the debate"*

In particular, for a political union such as the EU, the decision to centralise policies depends not only on efficiency considerations, but also on whether it is seen as *legitimate* to reduce national sovereignty over those policies. Therefore this paper proposes to integrate the economic literature on fiscal federalism with the political literature on the legitimacy of the EU. To that end, it adapts the theory of fiscal federalism to the EU, by incorporating the concept of legitimacy into the analysis.

Legitimacy is a concept used in the political science literature to express the notion that a government, or its actions, are rightful and justified. The academic literature on legitimacy proposes several ways to assess that rightfulness. This paper identifies six major factors: public opinion – whether the citizens accept and support the government actions; accountability – whether the government actions were taken following a democratic political process; normative justifiability – this encompasses a number of subjective criteria to assess whether it is acceptable to have a certain policy at a certain level; legality - whether there is a legal basis for the government actions; technocratic – whether the government actions are efficient; and the existence of a collective identity or demos. These factors will be explained in more detail in Section 2. Section 3 will then incorporate them into the fiscal federalism analysis, and apply that analysis to different areas of policymaking to find whether these should be allocated to the EU level or to the national level.

This paper will take as its starting point both traditional fiscal federalism and "second generation" fiscal federalism. In a nutshell, traditional fiscal federalism says that a certain policy should be done at a more central level if this permits to internalize externalities or to reap economies of scale¹; however, if there is a significant heterogeneity of preferences (that is, if the people in the different countries want different policies) it should be done at a more decentralized level. Second generation fiscal federalism adds considerations of political economy to the analysis – it takes under account the existence of political failures at all levels of government, and seeks to identify the level of government that minimizes those failures.

Fiscal federalism analyses in general try to explain issues that relate to legitimacy through its traditional economic criteria. In particular, most authors will identify issues of legitimacy with the concept of heterogeneity; for example, they will explain the fact that there is opposition to the centralisation of welfare provision only with the differences in welfare systems in EU countries – while that is partly true, this paper will argue that the main reason for this opposition is that it is not seen as legitimate to transfer those policies to the EU level. On the contrary, this paper argues that, when deciding the allocation of policies between the EU and national level, legitimacy is an essential factor that must be made endogenous to the theory.

The rest of this paper is organised as follows. Section 2 reviews the political science literature on legitimacy and proposes how it can be incorporated into fiscal federalism. Section 3 analyses the different policy areas using traditional and second generation fiscal federalism together with legitimacy. The conclusion looks at the new insights originating from this approach.

2. MEASURING LEGITIMACY

The concept of legitimacy is by definition normative or subjective, and therefore it can be interpreted in different ways. A great part of the wide political science literature on legitimacy is precisely dedicated to finding how to best define the concept. The most recent political science literature sees legitimacy as a multi-faceted concept and takes under account its different aspects (see for example Beetham (1993) Lord and Magnette (2002)). This paper follows that approach, as it is argued that a complex concept such as legitimacy should not be reduced to a single factor, but instead should be derived from a number of factors that, together, create a notion that government policies are legitimate.

Six main elements of legitimacy were identified in the literature. Of these, three were considered to be useful for the analysis of how to allocate individual policies between the EU and the national level. I will begin by describing the three factors which will be used in the analysis. I will then describe the other three factors and explain why they were not considered useful for this type of analysis.

2.1 Factors used in this analysis

Public Opinion

¹ Externalities occur when a decision by an economic agent causes costs (or benefits) to other stakeholders, for which the agent does not bear the cost (or does not reap the gain). Economies of scale occur when average cost of producing a good decreases if the good is produced in a larger quantity.

The notion of legitimacy is ultimately based on public acceptance. Although in representative democracies the actions of government are not due to follow directly public opinion (elected governments can take unpopular measures, without that going against legitimacy), public opinion has the last word as politicians need to be (re)elected. In the case of the EU, public opinion assumes even greater importance, due to the lack of direct elections (see next section). Therefore, it is necessary to take it under account when deciding whether to allocate policies at the EU level.

Public opinion can be measured through surveys. The Eurobarometer surveys are undertaken by the European Commission to measure the opinion of EU citizens with regards to the EU. The surveys include a question which was designed specifically to measure the opinion of people on which policies should be allocated to the EU level. The answers to that question will be used in this paper to approximate public opinion.²

Accountability

Another essential element of legitimacy is accountability. The political process is accountable if policymakers are made to reflect the preferences of citizens in their actions. This can be ensured through the existence of a democratic political process, including elections and direct contest for the political office, and through a system of political institutions which guarantees checking mechanisms on political power.

The literature generally looks at the issue of accountability in the EU as a whole (often referred to as the democratic deficit), but not at the individual policies. However, in the EU the level of accountability varies widely between individual policy areas, as they have different levels of integration, different legislative processes are applied to different areas and some areas are easier to follow by citizens at the EU level than others. While there is no way to easily give a number to the degree of accountability of each area, it is possible to get an idea via these three factors.

Normative justifiability

The concept of normative justifiability was proposed by Beetham (1991). Beetham argued that legitimacy depended on three factors: legality (see next section), normative justifiability, and consent of the citizens (this factor can be related to public opinion, as defined above). Beetham defined normative justifiability as "rules should be justifiable by reference to shared beliefs" (Beetham, 1991). Those "beliefs" were of two types: "beliefs about the rightful source of political authority" and "beliefs about the appropriate ends or purposes that the government should serve" (Beetham, 1993).

The latter type of beliefs is relevant for this analysis – the beliefs about the appropriate ends and purposes of the European Union are of high relevance when analysing which policies should be done at the EU level. It is clear that there is no universal agreement on what are those appropriate ends and purposes, as views on what the EU differ between countries and even from person to person. Therefore, an analysis based on normative justifiability will give different results depending on each set of beliefs on the purpose of the EU.

² This paper uses the answers to Question A24 of Eurobarometer No. 66, December 2006: "For each of the following areas, do you think that decisions should be made by the (NATIONALITY) government or made jointly within the European Union?"

For the purposes of this analysis, this paper will propose a set of beliefs. It is argued that the EU was created with two main purposes or roles, and that still today, despite the expansion in EU powers, it is still relevant to keep those two main purposes as guidance to what the EU should do. These two purposes are: the Single Market and promoting peace in Europe. The EU was created with the purpose of avoiding future wars and tensions between its members, and that was to be done through the creation of a free trade area. Although since its creation the EU's areas of activity have expanded, and many would argue that it has now much wider objectives, these are the two only objectives that all Member States agree with, and where there is wide agreement that the EU should play a role.

To define these as the two objectives of the EU does not give specific guidance as to what the EU should do: the Single Market objective can be seen either in its narrow sense, where it justifies only a simple free trade area between the Member States, or in its widest sense, where it justifies a complete harmonization of economic policies, which itself can be seen (or not) as justification for a political union. Also, peace can be seen in its narrow sense (where no action by the EU is required in this field, because peace derives from the free trade area) or in its widest sense – where it justifies a common defence policy, a common foreign policy and the harmonization of internal/home affairs.

This paper proposes to consider as most legitimate the policies that are closest to those two areas. It should be noted that the analysis could also be made with a different set of assumptions regarding the normative justifiability of the EU, which would lead to different results.

2.2 Factors not used in this analysis

Indirect/Legal Legitimacy

Legal legitimacy requires that the actions of the government are derived from a legal source, and that the government is following legal political procedures. In the case of the EU, all policies and interventions follow a pre-established legal procedure, and all EU powers and responsibilities have been given to the EU by the national governments, so legal legitimacy exists. Some authors have also argued that the EU has *indirect legitimacy* – since all EU initiatives must be approved by national governments, themselves legitimate, that makes the EU legitimate as well.

However, although some authors defend that legal legitimacy and indirect legitimacy are sufficient to ensure the legitimacy of the EU (Moravcsik, 2002), others argue that the fact that a government action is legal is not sufficient by itself to conclude that it is legitimate (Follesdal and Hix, 2002). This paper will not use the principle of legality in the analysis, as it is not helpful in distinguishing between the different policies, as all EU policies are strictly speaking legal. Moreover, this author shares the view that this condition by itself is not sufficient.

Technocratic Legitimacy

Another source of legitimacy is related to “output” or “efficiency”. Its defendants say that the fact that a government action is efficient makes it legitimate, or at least contributes towards its legitimacy. According to this view, the legitimacy of the EU derives from the fact that the EU enables the Member States to address "common interests" and the EU is legitimate because it

provides benefits to citizens. This view would imply that fiscal federalism itself is a way of assessing legitimacy, as it would be legitimate to transfer a policy to the EU level as long as this increases efficiency. However, it is doubtful whether this can be seen as a source of legitimacy, as this would imply that a dictator, who would be ruling the country against the citizens' will, could be legitimate as long as he tried to rule it efficiently. It is of course highly desirable that government actions are efficient, but this should not be confused with legitimacy.

However, an exception could be made for certain policies, which can be done by "agencies". Moravzic defends that the EU is an agency of the Member States and therefore it should be independent from the political process, and therefore not subjected to the democratic process. This paper argues that this cannot be said to apply to the EU as a whole, because EU policymaking is involved with so many areas and has so much power that it could not be acceptable to say that all that should be exempted from the political process. However, there are two areas where this reasoning could apply: monetary policy and competition policy. These are two areas where there is wide agreement that they should be isolated from the political process, because the good functioning of the economy requires that they follow pre-set rules.

Collective identity/demos

Another factor of legitimacy is whether the government is representing citizens with a collective identity or "demos". In the case of the EU, this would require that citizens identify with the European Union or "feel European". To a large extent this is not the case, as surveys show that people identify much more with their nationality than with Europe. However, several authors have argued that this condition is not necessary, as long as the EU meets other requirements of legitimacy (for example, Scharpf, 1999).

This paper agrees with the latter view, for two reasons. Firstly, examples such as the UK show that a government can be legitimate even if its citizens identify more with their regional identities than with their national identity. Secondly, and most importantly, the EU is not replacing the Member States, and the powers of the EU are much smaller than those of the national governments. As long as national governments have more powers than the EU, the fact that national identity is felt more strongly than European identity is not a problem. This paper therefore does not see this condition as essential. Moreover, this factor would not provide guidance in the differentiation between policies.

3. APPLICATION TO EU POLICIES

This paper will therefore focus on the normative justifiability, public opinion and accountability of policies. I now apply these criteria to different areas of EU policymaking. For each area, I will first briefly summarize the insights from traditional and second generation fiscal federalism, and then complete those with the analysis based on legitimacy.

Defence and Foreign Policy

Traditional fiscal federalism says that defence policies should be centralised, as to benefit from economies of scale: by pooling their resources, Member States could make their defense systems more efficient and save money by avoiding duplication. In the areas of foreign policy that are not directly related to defence, there are also economies of scale, because by pooling

their efforts the Member States can improve their standing in the international scene. However, there is a very significant problem of heterogeneity, because Member States have very different foreign policies. The solution generally advised by the literature is to centralize only the least sensitive areas.

Second generation fiscal federalism adds that there is a political failure at the EU level, which would justify to keep this policy at the national level: the incentive to free-ride, as it is possible that some countries would chose to benefit from the spending of other countries, without spending themselves (Persson, Rolland and Tabellini, 1996). However, the authors conclude that the best solution is still to harmonize, while being careful to prevent this problem.

I now move on to the analysis based on legitimacy. Concerning normative justifiability, defence and foreign policies are related with the objective of achieving an area of peace and security in Europe. However, "peace" was originally understood mostly as internal peace – avoiding wars and conflicts between Member States. Moreover, this was to be achieved through the integration of economic interests. Therefore, if we take the narrow definition of this objective, a common foreign policy is not justified.

If we take a wider definition of this objective, where the EU can contribute towards peace and security within the EU in general, that gives legitimacy to harmonizing foreign policy and defence policy, at least in the areas that are most related with achieving a climate of peace and stability in Europe. For example, fighting terrorism is an area which has great impact on the external security of the EU, and where collaboration between the Member States can be effective in increasing that security. On the contrary, general foreign policy and diplomatic relations with other countries is only indirectly related with security within the EU, therefore there is less justification for action at EU level.

In what concerns public opinion, the "subsidiarity question" in the Eurobarometer shows a very wide support for "Defence and foreign affairs" at EU level: 64%. This may be due to a perception that, due to the relatively small size of EU countries, joining efforts will make EU countries safer and more powerful in the international scale (economies of scale).

In what concerns accountability, defence is an area where, even at national level, decisions are often taken out of the public eye and/or without following public opinion. This is due to the need for confidentiality regarding some public safety information, and to reasons of diplomacy and relations between countries, which often lead governments to ignore the public opinion. Therefore this is an area where the government has a large amount of leeway in its decisions. While citizens accept a lower level of accountability in this policy area at the national level, it is likely that they would find it less acceptable at the EU level.

Therefore, from the point of view of legitimacy, normative justifiability would justify centralising the aspects of foreign and defence policy that are most directly related with ensuring security within the EU. This should be combined with the conclusion from first and second generation fiscal federalism, that the areas where heterogeneity of foreign policy does not cause a problem should be centralised to benefit from economies of scale. This implies that the Member States should centralise at EU level the areas where they have similar approaches, especially to deal with concrete security problems.

Education and Research

The literature on traditional fiscal federalism is divided. Some authors defend that these policies should be at EU level, due to the existence of economies of scale, as Member States can pool their research capacities and human capital, and avoid the duplication of research (Hoeller et al, 1996). On the contrary, others argue that these policies should remain at the national level due to heterogeneity, as EU countries have very different approaches in their educational systems (Alesina et al, 2001).

Concerning second generation fiscal federalism, Persson et al argue that, since educational systems are inefficient and badly organised in European countries, harmonization, by increasing the competition between the countries, could increase efficiency. Moreover, several aspects of policies can help tackle another EU-wide market failure: the insufficient mobility of the workers between EU countries. Programmes such as the existing Erasmus (which finances university students who want to spend one year of their studies in another Member State) are particularly useful in this respect.

This paper argues that it is necessary to differentiate between primary and secondary education on the one hand, and university education and research on the other hand. The former should remain national, as it does not involve significant economies of scale or externalities but does involve large heterogeneity. The latter on the contrary should be at least partly centralised at the EU level, as it involves large economies of scale – due to past -, and no large heterogeneity problems.

This division applies not only in terms of efficiency but also in terms of legitimacy. There is extremely wide support for EU action on “scientific and technologic research”, with 70% of the population thinking that the EU should be active in this field. On the contrary, there is very low support for EU action in “the education system”, with only 29% of the population thinking that the EU should have any involvement in this area. This may be due to the fact that people want to keep at the national level the policies that touch them most directly, such as the education system, while at the same time they support to transfer to the EU level policies where they feel that cooperation between the Member States can lead to more efficient results.

In what concerns normative justifiability, research policy is directly related to the Single Market in two ways. One is that research and development is an integral part of companies' activities, and therefore to have a single market it is necessary to have a regulatory environment that allows EU-wide research. The other is that research at EU level fosters the mobility of researchers, and the mobility of workers is needed for the Single Market. Education has no direct relation.

Concerning accountability, if parts of primary and secondary education were to be transferred to the EU level, it is likely that there would be no problems of accountability, as these are areas that touch more citizens directly and would therefore be well followed. However, these are also areas where very high accountability is demanded by citizens.

Concerning research policy, this is an area where the political process can be made more efficient by delegating part of the decision-making to an independent agency. This is because government intervention in the field of research involves spending, and that spending can be made more efficient if they are impartial and independent. For example, an independent

agency to award research funding. Therefore, having a national or an European independent agency brings equal accountability.

In conclusion, concerning education, a legitimacy analysis confirms the conclusions from standard fiscal federalism that policies should not be centralized. Concerning research, the analysis also confirms the case for centralisation, as long accountability of EU level research policies is improved, and the policies are focused mainly on allowing companies to undertake cross-border research.

Common Market and External Trade

Fiscal federalism supports the Single Market, as unifying the Member States' markets leads to very large economies of scale: the bigger the market, the more efficient it will become as there will be more firms and therefore more competition. Here external trade is considered as part of the same policy field, because having a Single Market requires having a single trade policy. Second generation fiscal federalism confirms this conclusion: if markets are over-regulated at the national level, EU level deregulation brings improvements in efficiency.

The definition of normative justifiability used in this paper clearly supports these policies. Unfortunately the Eurobarometer question does not include these policies, so there is no measure of their popular support. However, the accountability is lower at the EU level than if markets remained closed: these areas are complex to understand and not much followed by public scrutiny, they are areas where the EU has very wide powers and the legislative process in effect give very wide powers to the Commission. Nonetheless, the benefits of EU integration are so wide in this area that this paper would argue that it is best to keep very close integration while ensuring that accountability problems are minimized.

Competition Policy

Traditional fiscal federalism makes a very strong case for competition policy at EU level. Given the existence of a Single Market, the externalities caused by different competition policies would be very large. A single market requires a single competition policy. Moreover, heterogeneity is low, as there is a growing consensus regarding the optimal type of competition policy. Second generation fiscal federalism finds that the risks of regulatory capture are similar at EU and at national level.

From the point of view of normative justifiability, as the Single Market is the core EU responsibility, as competition policy directly supports the Single Market, it is clearly normatively justifiable. Public support is considerably high at 54%. In what concerns accountability, competition policy is one of the most transparent policies at EU level, as the Commission follows pre-determined rules and is required to explain all its decisions based on those rules.

Social Security, Employment, Taxation and Health

Traditional fiscal federalism would argue in favour of centralising redistribution policies due to externalities – different levels of social security could lead to individuals and firms moving to where the tax system is most favourable leading to distortions and harmful tax competition. However, this problem is not very relevant in the EU, as mobility is very low. Moreover, the problem of heterogeneity is so large that it is best to keep those policies at a

national level. Second generation fiscal federalism also advises national level, since under the current political system in the EU it would be difficult to have centralised decision-making on this issue, as countries are focused on extracting as much money as possible from the EU.

Social policy is not directly related to either the Single Market or peace. This excludes only the aspects of social security that are related to the mobility of workers, such as social security arrangements for mobile population regarding the possibility to transfer pensions from one country to the other, for example. There is clearly justification for doing these arrangements at EU level.

Moreover, public opinion is very largely opposed to transferring welfare policies to the EU level. Only 27% support have some aspects of health and social welfare at EU level, 25% taxation, 23% pensions. This may reflect a wish to retain control over policies that touch citizens most directly. It may also be related to the fact that citizens are generally not comfortable with the thought of transferring too much of their taxes to the EU level.

Accountability would be high at EU level, as these areas are well-followed by citizens, as they involve taxes and touch people's daily lives; but on the other hand, as with education, these are areas where a very high level of accountability is demanded, and even more if they were at EU level.

Cohesion policy

Cohesion policy, which consists of transfers to the poorer regions of the EU to help them catch up with the rest of the Union, must by definition be done at the EU level, so the question addressed by fiscal federalism is not at what level this policy should be done, but how much, if any, of the EU resources should be dedicated to it.

Traditional fiscal federalism generally justifies Cohesion Policy as being necessary for the Single Market (find example). However, this paper would argue that Cohesion Policy should also be seen as meeting an EU-wide equity goal: that of allowing poorer countries to catch up with the average, so that all Member States attain the same level of prosperity.

Insofar as cohesion policy is seen as a necessary condition for the successful Single Market, it would have normative justifiability; that is not the case for the solidarity goal. Public opinion is very divided on this, with 57%. In great part this reflects the fact that some countries receive funding, while others give it out. This shows that Europeans do not feel much solidarity towards citizens of other Member States.

Therefore a legitimacy analysis completes standard fiscal federalism analysis with the conclusion that cohesion policy is more legitimate if it is directly focused towards improving the Single Market.

Environment policy

Traditional fiscal federalism defends the centralization of environment policies, due to the existence of large negative externalities among the Member States. These externalities are constituted not only of environmental effects themselves but also of distortions to the single Market cause by different environmental standards. However, there is large heterogeneity in the preferences towards levels of environment protection (for example, the Scandinavian

countries want a very high level of environment protection, whilst the populations in the south of Europe are less concerned with those issues), so the centralization should be limited to some policies.

There is a very high level of public support for environmental policies at EU level, with 64%. This is probably due to a perception that environment is an international issue as pollution doesn't stop at the borders. Concerning accountability, environment is an area of policymaking that is generally understood by people and followed by the media, so it is likely that the same would happen at EU level. Concerning normative justifiability, environment policies are related to the Single Market only insofar as they relate to environmental regulations that, if they are different, could hamper the Single Market. Therefore, harmonization at EU level on the types of chemicals allowed in products is justified. On the contrary regulations on protection of animal species are not.

Agriculture

Traditional fiscal federalism strongly advises that these policies should be kept at the national level as there is no case for centralizing them: there are no externalities or economies of scale involved, and on the contrary there is a large heterogeneity problem, as preferences for how to sustain the countryside vary enormously among countries. Second generation fiscal federalism adds that there is a significant case of political failure involved – offering a further reason to keep these policies at the national level.

EU policies on agriculture are not normatively justifiable; they are not needed for the Single Market and are not linked to security issues. The popular opinion is mixed with 49% – this can reflect the fact that some countries benefit from funding while others are net payers. Accountability is clearly a problem at EU level, as the policy has been captured by lobbies. In this case the legitimacy analysis confirms the clear conclusion of the fiscal federalism that there is no case for agriculture at EU level.

Home Affairs

The term “justice and home affairs” groups issues that at national level are covered by the interior and justice ministries: the fight against crime, the safety of citizens, immigration and the justice system. Traditional fiscal federalism says that, due to the opening of the borders between the Member States (following the Schengen agreement), several safety issues now have such large externalities between countries that they have become effectively common to all Member States (they have become “EU public goods”). Examples are international crime, immigration and protection of the common borders of the EU. Those policies should therefore be centralised.

On the contrary, there is no case for centralizing the policies that only impact on the national or local level, such as the justice system – they have by definition no externalities with other countries and there would be large heterogeneity problems.

The opening of the borders between the Member States is related to the movement of workers, which itself can be seen as part of the Single Market. Also, these issues could be seen as related to the objective of peace within the EU territory. Therefore they derive their legitimacy from both sources.

Concerning public opinion, the Eurobarometer does not include a question relating to home affairs in general, and instead asks about individual policies: fighting terrorism, fighting crime and immigration. Public opinion is very supportive of policies to fight terrorism at the EU level. 79% think that the EU should have responsibility for fighting terrorism. This is most probably due to a perception that this problem can only be tackled effectively at an international level – a perception that there are large externalities. Support is lower but still positive for fighting crime (59%) and immigration (57%). Concerning accountability ASK

4. CONCLUSION

This analysis has given several new insights, which complete the conclusions from standard fiscal federalism. In particular, it showed why certain policies which fiscal federalism analysis says should be centralised have not been. For example, research policy is an area where fiscal federalism advocates centralisation, due to large potential economies of scale. However, legitimacy analysis shows that the centralisation of those policies might have been opposed by governments because it is not seen as legitimate to give away support for strictly national research. Moreover, research is only linked to the core objectives of the EU (as defined in this paper) insofar as it relates to allowing companies to undertake R&D freely throughout the EU.

Another example is foreign policy, and particularly defence policy. This is an area where it would be efficient to centralise, due to large economies of scale. Therefore traditional fiscal federalism strongly advocates EU level. However, a legitimacy analysis helps to explain why this policy has remained at the national level: under this paper's definition of normative justifiability, foreign policy is only indirectly related to the goals of the EU.

The analysis also gives insights on what makes some areas legitimate at EU level as opposed to others. In particular, it shows that legitimacy is lower if the policy involves transferring large amounts of money to the EU level. There a number of reasons for this: firstly, public opinion is opposed to too many taxes going outside the country; secondly, funding at EU level is more at risk of capture by lobbies (as can be seen in the case of agriculture); thirdly, the most important policies for the good functioning of the Single Market are regulatory as opposed to relying on funding. This could explain why the EU budget remains relatively small despite the growing powers of the EU on the regulatory front. It also argues in favour of, when a policy is transferred to the EU level, giving the EU more powers on the regulatory aspects and less funding.

Legitimacy is also lower if the policy touches people directly. Examples are education or health policies; public opinion is widely opposed to their transfer to the EU level, and they are not directly linked to the core EU objectives.

It could be argued that legitimacy and heterogeneity are the same. However, that is not the case: heterogeneity reflects differences in tastes and traditions which make it difficult to implement the policy in practice and to satisfy everyone, which is different from whether it is legitimate to give up national sovereignty in a certain area or not. The example of research shows that there can be low heterogeneity and at the same time low legitimacy.

This paper has also offered a way to operationalise the concept of legitimacy, as to include it in an economic analysis. This was done by identifying, from the political science literature,

three concepts that make it possible to apply in a relatively objective way, this very subjective concept.

The literature on fiscal federalism has so far not taken centre stage in the debate on the Future of the EU. This is partly due to the fact that this literature so far appeared to be out of touch with the reality of the EU, as it ignored political considerations. It is argued that the "European version" of fiscal federalism proposed in this paper can contribute towards bridging the gap between the academic work and the policy debate on the EU competencies.

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