

## The Benefits of Federalism and the Risk of Overcentralization

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### I. INTRODUCTION

In Europe and also in countries like Canada or South Africa, there are intensive debates if and how the structures of federalism ought to be strengthened. What can economics contribute to this discussion? The answer is unclear. On the one hand, the theoretical arguments in favour of and against federalism tend to counterbalance each other, and many empirical results are equivocal. On the other hand, demand for federalism in the post-constitutional political process might be small, as neither federalism itself, nor concomitant political competition is in the interest of the 'classe politique' and of most of the well-organized interest groups.

This contribution takes up these arguments. The analysis of the underlying assumptions reveals the relative advantages of decentralized political structures, so far not correctly assessed in the economic literature. In part II, the predominant arguments for and against federalism proposed in the literature are presented. In part III, this literature will be critically discussed. Many of its arguments are built on highly restrictive assumptions. It often lacks a comparative perspective, and reactions in the post-constitutional political process are neglected. Some elements of a more comparative, process-oriented approach are presented in part IV, where the problem of endogenous centralization will be discussed. Several conclusions for a future European constitution will be drawn in part V. In the last section the arguments will be summarized.

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## II. THE ECONOMIC APPROACH TO FEDERALISM

1. *The Main Arguments*

'Federalism' has different meanings in economics, politics, and in the vernacular. The various interpretations range from real *decentralization* (where local and regional governments have their own competences), over *delegation* (where lower level governments act as agents of the central government) to *deconcentration* (where the central government is dispersed to regional branch offices) and to the nebulous concept of *subsidiarity* (see, e.g., BIRD [1993, p. 202 and Fn. 9]; ADONIS and JONES [1991]). Because of this diverse linguistic usage, many statements from politicians in favour of federalism prove to be lip service from an economist's point of view (HAILBRONNER [1991, p. 485f.]).

In contrast to the general concept of federalism, the economic discussion is highly standardised and mainly concentrates – as this essay does – on federalism as real decentralization where the lower level jurisdictions have competences on regulating expenditure as well as revenues. Sometimes, as in Germany, the US or Switzerland, they even have a say in decisions at the central level. Most of the economic arguments in favour of and against this type of federalism have been known at least since OATES' [1972] and BRENNAN and BUCHANAN'S [1980] path-breaking contributions (see PRUD'HOMME [1991] or GOETZ [1992]). The following advantages of decentralization and centralization, respectively, are regularly mentioned (see also FREY [1983]):

*Advantages of Decentralization*

- Regionally differing preferences can be better taken into account.
- Lower planning and administrative costs, as bureaucracy can be reduced.
- Smallness and competition favour organizational and political innovations.
- More efficient politics as citizen have more influence.

*Advantages of Centralization*

- Spill-overs can be taken into account by central coordination.
- Economies of scale can be exploited.
- Better coordination.
- Minimal provision of certain public goods can be guaranteed.
- Redistribution policy becomes feasible.
- Effective stabilization policy becomes possible.

These arguments are fundamental to the modern economic discussion on federalism where they are brought forth in indefinite variations (BIRD [1993,

p. 202]). Some authors build on these arguments when proposing that, e.g., the future European constitution should incorporate much more elements of federalism than is the rule today<sup>1</sup>. Others – in contrast – use these arguments to corroborate their claim for more coordination and a stronger role of the central government (e.g., INMAN and RUBINFELD [1992]).

2. *Politico-economic Aspects*

Political economists also refer to the arguments mentioned above, but concentrate on two issues. Based on the work of BRENNAN and BUCHANAN [1980], it is analyzed whether political competition between local governments may effectively bind the Leviathan state thus increasing efficiency. In much of this mainly empirical literature it was investigated whether centralization leads to a growing state as BRENNAN and BUCHANAN suspected. While the results seem to be hopelessly contradictory at first sight<sup>2</sup>, some similarities can be found [OATES, 1989]. Although international cross-sections exhibit no evidence of a relationship between the extent of centralization and the size of government, a positive relationship can be found in time series of the United States. Moreover, weakening or merging general purpose jurisdictions, i.e., centralization, seems to raise the aggregate government budget, whereas weakening and merging single purpose jurisdictions has the opposite effect (see, however, ZAX [1988] for counter-evidence on this point). These results are often interpreted as evidence that federalism does not put hard constraints on the politicians in government and thus does not enhance efficiency (see, e.g., HEIL [1991]).

The second aspect analyzed are spill-overs. In contrast to the traditional literature, however, oversupply of public goods is investigated nowadays, not undersupply. When local governments do not have to carry the full cost of their services as they are subsidized by vertical or horizontal grants, they have an incentive to 'overextend' their supply and thus the size of government<sup>3</sup>.

However, some of the arguments discussed are theoretically and empirically flawed, as will be shown in the following section.

1. See, e.g., BUCHANAN [1991]; SCHNEIDER [1992]; BLOCHLIGER and FREY [1992], or BIRD [1993].
2. A positive relationship between centralization and the size of government is reported, e.g., by MARLOW [1988]; ZAX [1989]; RAIMONDO [1989], and GROSSMAN and WEST [1994]. No clear relationship could be found, e.g., by OATES [1985]; NELSON [1987], and HEIL [1991], whereas FORBES and ZAMPELLI [1989] find even a negative relationship.
3. See OATES and SCHWAB [1988]; GROSSMAN [1988, 1989]; TAYLOR [1992].

## III. A CRITICAL ASSESSMENT

1. *Theory**Unrealistic Assumptions*

Many of the arguments in favour of and against federalism build on very peculiar assumptions which do not mirror reality. One of these assumptions is perfect or at least very high mobility of the citizenry, an assumption which can not be upheld in the light of the evidence from highly decentralized Switzerland. Thus, the argument that mobility renders income redistribution policy (and the provision of other public goods) impossible in a decentralized political unit because the rich and high income recipients evade taxation by migration is not compelling. As recent empirical studies confirm, lower level governments are indeed actively and successfully redistributing income to large extents (for the US see GOLD [1991], for Switzerland KIRCHGÄSSNER and POMMEREHNE [1993]). Another frequent (implicit) assumption is that decentralization leads to heterogeneous policy between local governments while centralization induces homogeneous policy. This, however, need not be true. Central governments may differentiate their policy according to local preferences and delegate decisions to local authorities. On the other hand, in decentralized countries local governments try to coordinate their policy (see OAKERSON and PARKS [1988]; Centre for Economic Policy Research [1993]) and may thus internalize externalities, exploit scale economies, agree on the supply of certain public goods, and provide stabilization, thereby solving many of the alleged problems of federalism. Following WITTMAN [1989], who argues that democratic processes are efficient, one could even hypothesize that the endowed competences are irrelevant, because the efficient allocation of competences emerges from the post-constitutional political process. Although this hypothesis is obviously too extreme, it nevertheless points to an important issue: economists should not only investigate which level is efficient in providing and producing a service (i.e., to follow in a certain respect a result-oriented approach), but they should analyze the endogenous centralization and decentralization processes more thoroughly (and thus follow a process-oriented approach). These questions will be looked at in part IV.

*Nirvana Approaches*

In the economic literature on federalism, the efficiency of decentralized decisions is often compared to a theoretical optimum and not to centralized decisions. In the literature on biasing effects of grants and on tax harmonization (see

SINN [1990], for example, the relative efficiency of decentralized compared to centralized decisions is rarely looked at. Therefore, the fact that centralized systems are not Pareto-efficient either is often neglected. Thus, in centralized countries central financing of local public goods may cause even more rent seeking by local representatives than in decentralized systems with grants financing. Despite this obvious bias against the advantages of federalism, many of these contributions draw conclusions in favour of centralization and against federalism (see, e.g., GROSSMAN [1988]). However, comparative considerations are not only neglected by many 'centralists', but by 'federalists' as well, who only see the advantages of decentralization and neglect the respective disadvantages. In some respect, economists are living on two islands of knowledge without taking notice of each other (see FREY and EICHENBERGER [1993]). Contributions trying to combine these two points of view are rare [BELL, 1989].

2. *Empirical Results**Decentralization and Government Size*

One of the few truly comparative approaches to federalism consists of the already mentioned contributions that empirically investigate the interdependence of centralization and size of the government based on BRENNAN and BUCHANAN's Leviathan model. This research builds on the hypothesis that centralization weakens the constraints of the governments and increases their ability to overextend activities. Thus, the more centralized a jurisdiction is, the more the overall size of government (measured in terms of budget size) increases. This hypothesis is based on the crucial assumption that the citizens cannot react to these inefficiencies. From a more general point of view, however, the opposite hypothesis could be supported as well: The more centralized a jurisdiction is, the less governments are forced to follow citizens' preferences and the less the quality of government services fits the citizens' preferences. Therefore, centralization may reduce the citizens' demand for public services, thereby decreasing the size of government. For such a negative impact of centralization on government size to exist, demand for public services has to influence the politico-economic equilibrium in centralized polities. For this, three arguments can be adduced.

- As discussed above, centralization weakens competition among the various governments. Government services are therefore, likely to increasingly deviate from citizens' preferences quantitatively and qualitatively. Simulta-

neously, however, other constraints may become tighter on the central level. In centralized countries the exit of tax payers into the shadow economy tends to be more prevalent. Theoretical and empirical research suggests that tax morale is lower and the willingness to withdraw income is higher, the more public services deviate from the preferences of the population (COWELL and GORDON [1988]; POMMEREHNE and FREY [1992]). Moreover, by reducing barriers to mobility, centralization raises the anonymity of the citizens facilitating tax evasion and working in the shadow economy. Both the increased willingness to evade taxes and the improved possibilities to do so constrain the government's ability to exploit the citizens by increasing taxes and overextending government services.

- Citizens are not condemned to endure passively the increasing exploitation by the central government. They are likely to understand the underlying processes and to react accordingly. Even if the instruments to control the government in the post-constitutional stage are weakened by centralization, citizens can try to constrain the government by constitutional provisions. With increasing party competition and a wider range of direct democratic instruments, the citizens can constrain the government in those areas where it deviates strongly from their preferences. The less citizens can react specifically to particular government policies, the blunter their reaction has to be. They can, e.g., vote for parties proposing extreme budget cut backs or for far-reaching privatization programs. They may support general tax ceilings such as 'proposition 13' in California, even if they are aware that such strong constraints on government activity may negatively affect government services they appreciate. The reaction of the citizens may thus cause constraints of the Brennan-Buchanan-type to endogenously emerge.
- The citizens will react strongly to an extension of the government's discretionary power as a result of centralization, because they not only have to bear the budgetary cost of government activity, but its entire welfare cost. Typically, the latter are much higher than the former, as government activities induce rent seeking and because financing government activities causes high dead weight losses (see STUART [1984]; BROWNING [1987]). As rent seeking is usually more intense at the central level<sup>4</sup>, it can be hypothesized that the welfare cost of government services are higher, the more centralized a jurisdiction is.

4. See, e.g., FREY and BUHOFER [1986]; PEIRCE [1991]; ANDERSEN and ELIASSEN [1991].

It follows from these arguments that there need not be an unequivocal relationship between centralization and the size of the budget. Just because centralization increases the government's opportunities to exploit the citizens, the budget may decrease provided the citizens are able to react accordingly. Depending on the reaction of the population, three cases can be distinguished: (i) Centralization leads to a growing government budget and growing rents for government politicians. (ii) The size of the budget and government services decrease, but the politicians' rents still increase. This is the case, when the politicians value the increases in their discretionary power higher than the losses from the budget cuts. (iii) The budget as well as the rents decrease. This, however, will normally not lead to centralization, because the citizens and the government politicians loose by centralizing. The exact relationship between centralization and government size depends on the population's possibilities to react, which so far have not been satisfactorily identified. These theoretical considerations are consistent with the equivocal results of the empirical research on centralization and government size. Thus, a negative relationship between centralization and government size should not be interpreted as a case against federalism<sup>5</sup>.

#### *Land Prices*

Another way to illustrate the relative efficiency of centralized and decentralized political units is to look at land prices. Houses and land are immobile, thus the rents from good politics should materialize in the form of higher prices. If federalism induces better politics, house and land prices should be higher in relatively decentralized jurisdictions. Indeed, an extensive literature exists on the effect of competition between local governments on land prices<sup>6</sup>. Mostly, the impacts of taxes and public expenditures have been investigated. Obviously, lower taxes and higher public expenditures lead to higher land prices. While these results used to serve as proof that federalism forces the governments to behave efficiently, they are interpreted more cautiously nowadays: They merely reveal that individuals and firms take fiscal variables into consideration [CHAUDRY-SHAH, 1988]. More recent studies test effectively for efficiency. However, they all focus on whether competition between regional or local governments leads to absolute efficiency. They do not operationalize the extent

5. Consequently, the effects of centralization on government efficiency can only be tested correctly, when variations in government output are controlled for (see, e.g., MEHAY [1984]).

6. See, e.g., OATES [1969]; KING [1977]; HOYT [1990]; GYOURKO and TRACY [1991]; an excellent survey is CHAUDRY-SHAH [1988].

of decentralization or consider institutions. Thus, they provide no insights into the relative efficiency of decentralized and centralized jurisdictions. Unfortunately, comparative studies of land prices in jurisdictions with varying degrees of decentralization do not exist.

So far the discussion shows that it is difficult to judge the relative efficiency of centralized and decentralized political systems by consulting the standard theoretical and empirical literature on federalism. In the following some elements of a more process oriented approach are presented.

#### IV. ELEMENTS OF A PROCESS ORIENTED ANALYSIS

Process-oriented approaches judge federalism favourably based on three arguments building on the power of exit and voice: (i) By voting on foot, individuals can consume those government services they like best [TIEBOUT, 1956]. (ii) Competition between regional and local governments forces governments to pay attention to individual preferences [BRENNAN and BUCHANAN, 1980]. (iii) The incentives of the citizens to vote and to actively take part in the political process are higher, the smaller the jurisdiction is they live in (because the chances to influence politics increase, see DOWNS [1957]). Although each of these arguments is sound as such, their aggregate effect needs to be investigated, as it may be claimed that exit and voice are negatively related (see HIRSCHMAN [1970]): The easier exit is, the lower are the incentives to take up the voice option. Therefore it could be argued that decentralization increases exit but decreases voice, and thus has an ambiguous impact on the government's constraints. In the following, the interplay of exit and voice and thus the demand for government services depending upon the degree of centralization will be analyzed. Then the supply side will be looked at which will allow us to endogenize the extent of centralization.

##### *1. Demand for Government Services: The Significance of Exit and Voice*

The negative impact of exit on voice is taken to be a matter of course. It was not until HIRSCHMAN's [1993] attempt to explain the sudden breakdown of the German Democratic Republic in 1989 that the reverse hypothesis was brought forward. In repressive political systems voice can increase when the government eases exit, as this may signal a novel, serious and general decline in state authority and a decrease in government's ability and readiness to repress voice. However, such positive influences of exit on voice are not limited to non-democratic

countries, but are of foremost importance in federative democracies, too. Three arguments are relevant:

- In centralized democracies, participating in the political process and collecting information on the various political alternatives are public goods. Therefore, the population is 'rationally ignorant' and tends to abstain from political activity [DOWNS, 1957]. In largely decentralized countries, on the other hand, citizens' incentives are dramatically different. Individuals can use their information to choose the jurisdiction that provides the best services and the lowest taxes. Information on political alternatives thus becomes a private good. However, information not only empowers citizens to vote with their feet. It is also a precondition to effectively exercise the voice option and to take part in the political process. Consequently, individuals' capability to take up the voice option increases, the more decentralized a political unit is<sup>7</sup>.
- A related argument can be made with respect to the incentives to take up the voice option. Many economic actors and interest groups are more concerned with the relative, rather than the absolute, level of taxes and government services. Producers, for instance, are mainly interested in the taxes to be paid and government services to be had in comparison to their competitors. Thus, in a centralized country with uniform politics, the incentives to take up the voice option are small; they increase, however, with the ability of interest groups and firms to influence their relative position, i.e., the more decentralized a political system is.
- In decentralized countries the incentives to actively take part in the political process are further strengthened, because the individual influence on politics is larger, and personal, local relations are more important than in centralized countries. Thus, individuals and firms have incentives to invest in jurisdiction-specific, local human capital and relations. Consequently, decentralization strengthens local attachment of individuals and firms. This counteracts the direct effects of decentralization on the incentive to migrate.

7. It could be argued that these considerations are not convincing in the light of the low turnouts in votes and elections in direct-democratic Switzerland. However, the turnout not only depends on individuals' political information, but also on many other factors that differ between direct and representative democracies as, e.g., the citizens' satisfaction with government policy and the frequency of votes.

According to these arguments decentralization not only fortifies the exit option of individuals, firms and interest groups, but it also strengthens their incentives and instruments to articulate their preferences, i.e., to take up the voice option. Thus, decentralization puts pressure on the political decision makers to follow the citizens' preferences by bolstering exit *and* voice.

### 2. Supply of Government Services

Decentralization also directly changes the constraints on the supply side. As already noted, in centralized countries the decisions regarding local problems are not always made at the central level, but are partly delegated to local bureaucracies. Thus, bureaucracy has more weight in the decision process, the more centralized a country is. Following bureaucracy theory [TULLOCK, 1965; NISKANEN, 1971], it can be hypothesized that the decision makers in centralized countries will be less responsive to the public. Furthermore, in decentralized jurisdictions the market for politicians [SERNA, 1994] is not as closed to newcomers who can enter the political arena more directly. Furthermore, many political positions on the local level are part time and honorary. This 'deprofessionalization' of the politician's career weakens the influence of the '*classe politique*' (see OAKERSON and PARKS [1988]). Decentralization also tightens the constraints on the political decision makers at the central level. If elections at the central and at local levels are not held simultaneously, the party in power at the central level has to hold up popularity between central elections in order not to lose votes at the local level (see SIMON, OSTROM and MARRA [1991]). Pressure from the local to the central level can be transferred inside the ruling party and by federative institutions. In Germany, for instance, the result of the votes in the '*Länder*' carry over to the central level via the institution of the '*Bundesrat*'.

The discussion up to this point has stressed largely neglected aspects of federalism and pointed out that some of the arguments against decentralization do not hold. Nevertheless, concrete proposals on 'optimal decentralization' at the constitutional level cannot be advanced, as long as the various endogenous reactions in the post-constitutional process are not precisely known. The economic theory of federalism has to be supplemented by a theory of endogenous (de-)centralization, some elements of which are presented in the next section.

### 3. Endogenous Centralization

Endogenous centralization and decentralization, respectively, may result from two totally different motives. On the one hand, governments in decentralized as well as in centralized jurisdictions have incentives to delegate duties to those levels where they can be solved in a comparatively efficient way. These incentives result from the re-election constraint and the pressure of various interest groups. On the other hand, governments want to assign duties in a way that maximizes their own utility, i.e., enlarge their discretionary power and the rents they can appropriate. These entirely different sets of incentives systematically depend on the extent of centralization. As discussed above, the citizens' influence is larger in decentralized jurisdictions. At the same time the discretionary power and thus the rents of governments are higher at central than at lower levels. Therefore, governments in centralized countries are less inclined to delegate tasks to lower levels, than local and regional governments in decentralized countries are willing to delegate tasks to higher levels. Thus, in federative countries government tasks are more likely to be delegated to levels that are relatively efficient at fulfilling these tasks. It may, however, be worthwhile for lower level governments to coordinate their policy in order to eliminate competition which otherwise constrains them [GROSSMAN and WEST, 1994]. Often, such 'policy cartels' take on the form of centralization. This not only happens at the national, but also at the international level. According to VAUBEL [1986] and PEIRCE [1991], the delegation of competences from the nation states to the European Union provides an example.

Together, the two motives for delegation cause a specific asymmetry and can result in endogenous overcentralization. However, rational citizens will understand the underlying mechanisms and try to react accordingly. Their reaction again depends on the institutional conditions. Normally the citizens' instruments to prevent overcentralization are rather weak. Party competition often can not help because centralization is in the interest of the opposition as well. It is, therefore, important to give to the citizens effective means to prevent overcentralization and to break the politicians' cartel. How this can be achieved will be looked at in the next section, where the implications for a future European constitution are analyzed.

The above discussion highlights the beneficial effects of decentralization. In a constitution for a future Europe, the question of federalism should therefore not

be limited to the balance of power between the various governmental units at the European and at the national levels. The federative structure of the nation states ought to be addressed as well<sup>8</sup>. The optimal degree of centralization, however, cannot be derived from the arguments discussed so far, and it is even completely impossible to determine the optimal borders between local jurisdictions. The factors determining the optimal federative structure of Europe and the various European countries are unknown, as long as they are not revealed by political competition. Thus, 'optimal federalism' cannot be planned and implemented from above. In a European constitution, the processes have to be specified that allow 'optimal federalism' to endogenously emerge. For that purpose, three issues have to be focused on: Endogenous decentralization has to be promoted, endogenous policy coordination in favour of the citizens' interest should be possible, and endogenous overcentralization against the citizens' interests must be prevented.

For endogenous decentralization to work, the individuals must be given a wide range of opportunities to express their preferences and to choose accordingly. The fundamental mechanisms of voice and exit have to be strengthened. The first can be accomplished by improving the citizens' democratic rights. The second has to be institutionalized on the collective level by defining collective rights of secession (see BUCHANAN [1991], ZARKOVIC BOOKMAN [1992] and DRÉZE [1993]). In Europe, secession from the EU, from nation states and from the various forms of local government should be liberally regulated. The population of a certain geographic region should be as free as possible to form a jurisdiction of its own, without requirements concerning the minimal size<sup>9</sup>. Secession should not only be a legal option, but political alternatives for the seceding unit should be defined in advance. Countries or regions exiting the EU, for instance, could be given the right to enter a free trade agreement with the EU without further negotiations or conditions. Such predesigned alternatives lower exit costs and prevent that secession leads to new barriers and market distortions.

8. Interestingly, the discussion on the future European constitution concentrates on the former relationship, while the latter is often completely neglected (see, e.g., the proposals of the European Constitutional Group [1993] and of the HERMAN [1994] report from the European Parliament).

9. Such minimal requirements on the size of new jurisdictions have been recommended, e.g., by BERNHOLZ [1990] who proposes a minimal size of 10 millions inhabitants for new regions in the EU. In the light of the good performance of small countries like Luxembourg or Liechtenstein or small Swiss Cantons like Zug or Nidwalden such requirements seem at best questionable.

Centralization is often said to be in the citizens' interest, when economies of scale are increasing or when homogeneous policies are advantageous. In most cases, however, these benefits can be attained via bargaining and contracting among lower level governments without incurring the cost resulting from centralization (see the report by the Centre for Economic Policy Research [1994]). Thus, not centralization has to be furthered, but the lower level governments' leeway for bargaining and contracting. Today, this type of coordination among local and regional governments is often blocked by governments at higher levels or by administrative barriers. For coordination to endogenously emerge it is therefore important that local governments' rights of contracting with other local governments are strengthened, be it inside political units or across borders.

Federative structures can only be implemented and maintained if the forces effecting endogenous overcentralization can be bound. Endogenous overcentralization can be restricted by limiting the incentives and the possibilities of governments to centralize in their own interest. The selfish incentives of governments to centralize have to be weakened by reducing the European government's discretionary power. For this purpose, the democratic institutions of the European Union have to be strengthened. Besides adding importance to representative-democratic institutions and binding the council of ministers more tightly to the voter's preferences (e.g., by making its sessions public) direct democratic elements should be implemented at the European level<sup>10</sup>. The citizens should be given both the right of referendum (a certain number of citizens can require a vote on a decision of the government or the parliament) and initiative (a certain number of citizens can demand a vote on a proposal of their own), so that they gain control of the political agenda. The possibilities of the national governments to centralize selfishly can also be controlled by more democracy. The process of centralization itself has to be put under the voters' control. This can be achieved by submitting all centralization decisions to popular referenda or by allowing citizens to easily contest centralization decisions. Moreover, re-elections could be prescribed after each step of centralization. Indeed, empirical research reveals that direct democratic institutions restrict efficiency-decreasing overcentralization without rendering efficiency-enhancing centralization impossible (see DENO and MEHAY [1985] and NELSON [1990]).

10. The benefits and cost of direct democracy are extensively discussed, e.g., in CRONIN (1989); POMMERHNE [1990], and FREY [1994].

## VI. CONCLUSIONS

Many of the theoretical arguments and empirical results directed against federalism are not convincing. Some arguments are built on highly restrictive assumptions, centralization is frequently identified with overall homogenous policies, reactions in the post-constitutional political process are often neglected, and many contributions do not take a comparative perspective. On the basis of this critique elements of a more comparative, process oriented approach have been presented. Federalism strengthens the citizens' influence on the political process more thoroughly than has been acknowledged in the literature so far. Federalism not only improves the exit option but also gives incentives to citizens to collect political information and to actively take part in the political process, i.e., to take up the voice option. The degree of centralization is not seen as exogenous but as endogenous: Governments delegate tasks selfishly to higher levels in the post-constitutional political process. Hence, overcentralization may result. It is to be noted that federalism and democracy depend on each other. Democracy helps to prevent endogenous overcentralization, and federalism makes democracy work better, as it gives people incentives not to be 'rationally ignorant'. On the basis of these considerations, proposals for a future constitution of Europe have been deduced. A European constitution should not only promote federalism, it should also prevent endogenous overcentralization. This can best be achieved by strengthening direct democracy and by casing exit at individual and aggregate levels.

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## SUMMARY

In the economic literature on federalism, some arguments are built on highly restrictive assumptions. Centralization is frequently identified with overall homogenous policies, reactions in the post-constitutional political process are often neglected, and many contributions do not take a comparative perspective. On the basis of this critique, this contribution presents some elements of a more comparative and process oriented approach. The citizens' incentives to reveal their political preferences through voice and exit are analyzed. It is argued that easing the exit option increases the citizens' ability and their willingness to take up the voice option. Thus, federalism strengthens both exit and voice. The degree of centralization is not seen as exogenous but as endogenous: Governments delegate tasks selfishly to higher levels in the post-constitutional political process. Hence, 'overcentralization' may result. A future European constitution should therefore not only promote federalism, but also prevent endogenous overcentralization. This can be achieved by strengthening direct democracy and by easing exit at individual and aggregate levels.

## ZUSAMMENFASSUNG

In der ökonomischen Föderalismusliteratur beruhen einige Argumente auf sehr restriktiven Annahmen. Zentralisierung wird oft mit Vereinheitlichung der Politik gleichgesetzt, und häufig ist die Analyse nicht vergleichend. In diesem Beitrag wird deshalb versucht, einige Elemente eines stärker vergleichenden, prozessorientierten Ansatzes zu skizzieren. Unter anderem wird dabei das Zusammenspiel von 'exit' und 'voice' untersucht und argumentiert, dass 'voice' um so stärker wird, je besser die 'exit'-Möglichkeiten ausgebaut sind. Deshalb stärkt Föderalismus sowohl 'exit' als auch 'voice'. Das Ausmass der Zentralisierung wird als endogen angesehen. Die Regierungen wirken unter bestimmten Bedingungen im laufenden politischen Prozess auf zunehmende Politikkoordi-

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nation und Zentralisierung hin, was zu 'Überzentralisierung' führen kann. Eine künftige europäische Verfassung sollte deshalb nicht nur den Föderalismus stärken, sondern auch endogene Überzentralisierung verhindern. Dies kann erreicht werden, indem direktdemokratische Institutionen eingeführt und die 'exit'-Optionen auf individueller und aggregierter Ebene gestärkt werden.

RÉSUMÉ

Dans la littérature économique sur le sujet du fédéralisme, l'argumentation est souvent basée sur des hypothèses très restrictives. La centralisation est vue en tant que politique d'ensemble homogène; nombre d'études n'adoptent guère une perspective comparative. Cet article esquisse quelques éléments d'une approche plus comparative et plus orientée sur le processus politique. Il analyse les incitations des citoyens à révéler leurs préférences politiques à travers les possibilités d' 'exit' et de 'voice'. Lorsque l'option d' 'exit' est rendue plus facile, la capacité et la volonté des citoyens de choisir l'option de 'voice' augmentent. En outre, le degré de centralisation n'est pas considéré comme exogène mais comme endogène. Au cours du processus politique post-constitutionnel, les gouvernements délèguent dans leur propre intérêt des tâches à des niveaux supérieurs. Il peut résulter une centralisation exagérée. De telles considérations pourraient être appliquées à une future constitution européenne, laquelle ne devrait pas seulement encourager le fédéralisme, mais également prévenir une sur-centralisation endogène. Ce but peut être atteint en renforçant la démocratie directe et en facilitant les conditions d' 'exit' au niveau individuel et agrégé.