

# **Is Fiscal Federalism Different in the European Union? A Comparative Analysis Through the Allocation Function**

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## **Abstract**

A political-economic model largely influenced by the monetarist school inspires European Economic and Monetary Union (EMU). Accordingly, neither income redistribution nor resource allocation is the cornerstone of economic policy mix. That role is reserved to the stabilisation function. Among those scholars who discuss whether the EU is comparable to existing cases of “conventional fiscal federalism”, the analysis is frequently concentrated on allocation and redistribution. Despite macroeconomic stabilisation is the key aspect of EMU, the paper undergoes a comparative analysis between the European Union (EU) and five mature federations (United States, Canada, Australia, Germany, and Switzerland) as far as resource allocation is concerned. It first surveys the operation of the allocation function in these countries, concluding that there are remarkable differences when the countries under examination are measured within a centralisation/decentralisation continuum. Resource allocation is subsequently reviewed in the context of EMU to capture convergences and divergences with the federations examined – and to what extent do convergent aspects contribute to put a label on the EU in terms of fiscal federalism. The awareness that the discussion is sometimes plagued with conceptual oversight – the confusion between the *desirability* and *feasibility* of fiscal federalism in the European integration context – paves the way to the empirical dimension. The paper concludes with an input from statistical data assessing to what extent inter-state solidarity exists (or is absent) in the EU.

## **INTRODUCTION**

European monetary integration already embraces several aspects of federalism. Indeed some scholars perceive Economic and Monetary Union itself as a federal landmark in European integration (Pinder 1998, Buitier 1999, Burgess 2000, and McKay 2001). Hence, there has been a lively debate on whether EMU needs fiscal federalism. Comparative studies provide the background for the desirability and feasibility of fiscal

federalism in the European Union (EU): other monetary unions' institutional setting comprises fiscal federalism.

Political scientists do not agree whether European integration in general should be open to the comparative method. For some, the EU is a unique polity. Therefore, the EU should stand outside the realm of comparative politics studies for their inappropriateness regarding EU's sui generis nature (Burgess 2000, Dunn 2000, and Moravcsik 2001). Conversely, others acknowledge the potential of comparative studies. Notwithstanding they reckon the distinctive nature of European integration, they are aware of the polity dimension of the EU. For that reason, the EU cannot evade the comparison with other polities, especially with federal states (Jachtenfuchs 2002, Neyer 2006, and Inman 2007). The comparative exercise is open to contention, as some conclude that it provides a clear-cut federal nature of the EU (Elazar 2001, McKay 2001, and Menon and Weatherill 2002) while others reach the opposite conclusion (Crowley and Rowley 1998, Egeberg 2001, and Vrousalis 2006).

Two remarks for methodological purposes are needed at the outset. First, it is important to say something about the conceptual meaning of fiscal federalism. Here fiscal federalism is a constitutionalised system that focuses on the distribution of fiscal powers between the federal and state (and even local) governments in federal states (as parallels of the supranational and the national levels in the EU). This traditional understanding considers a threefold dimension (allocation-equity-stabilisation). '*Conventional fiscal federalism*' refines this concept. It is a characteristic of federal countries where fiscal federalism has deep-rooted traditions, with a discernible centralisation outcome as far as the overall assignment of policy competences is concerned.

The second methodological note concerns the reason why the paper chooses the resource allocation function and is silent about the other two functions (equity and stabilisation). Maybe on mature federations redistribution is a key function, especially because it involves inter-state mechanisms of fiscal compensation. Contrary to existing federations, inter-state solidarity is largely absent in the EU, perhaps as the illustration that no supranational identity (a European *ethos*) emerged so far. The result is that no political conditions exist in the EU to enforce a mechanism of inter-state compensation as typical of existing federations. Therefore, the equity function is meaningless in the EU context. Space constraints explain the choice of the allocation function and not the stabilisation function. Moreover, it is not so much the operation of macroeconomic

stabilisation that makes fiscal federalism noticed in federal countries. Interestingly, macroeconomic stability is a key aspect of economic policy-making in the EU, insinuating another source of dissimilarity between the EU and countries where ‘conventional fiscal federalism’ exists. Nonetheless, idiosyncratic reasons lying behind the specifics of European integration – and EMU in particular, with its “culture of stability” (Underhill 2002) – explain why this function is so important in the European context.

Although distinctiveness is one core aspect of European integration, this approach does not reject the comparative method. It might be useful to survey other federations, particularly to capture the features of ‘conventional fiscal federalism’. This method can be an interesting guiding light to assess whether the EU fulfils the conditions of ‘conventional fiscal federalism’. It can be helpful on two accounts: to find out that certain elements of fiscal federalism already fit with European integration, or the strong dissimilarities backed up by the distinctiveness of the EU.

Second, the comparative method is a useful tool to assess the feasibility of ‘conventional fiscal federalism’ in the EU. I examine the design and implementation of the allocation function in five federations (Australia, Canada, Germany, Switzerland, and the United States). These federal countries are the benchmarks against which the EU is compared. A crucial analytical tool is the degree of centralisation or decentralisation in each federation. This method can shed light to the EU, especially when the EU experiences comparison with other federations.

The paper proceeds as follows. Section 1 captures details on the provision of public goods in the five countries observed. By doing so, the goal is to draw conclusions on whether this function is centralised or decentralised. Section 2 assesses the allocation function within the EU, emphasising what is similar and different with mature federations. An interesting exercise is to test the feasibility of centralised provision of public goods in the EU. The concluding remarks stress that the uniqueness of the EU plays an influential role in bringing an outcome that differs from other federations. The question is whether this is consistent with ‘conventional fiscal federalism’ or whether it illustrates an alternative dimension of fiscal federalism.

## 1. RESOURCE ALLOCATION IN FEDERAL COUNTRIES

What is at stake with allocation is the provision of public goods assigned to the federal government and to lower tiers of government (Musgrave and Musgrave 1989, and Bailey 1999). One rough measure is to examine the distribution of taxing powers between the several tiers of government involved in the five federations observed (Inman and Rubinfeld 1999). It ranges from a system where concurrent powers are the key aspect, albeit hiding a strong centralisation bias, to other cases of absent rules on the allocation of taxing powers, to a third model showing a balance between the taxing powers assigned to the federal government and to lower units of government.

Taking the lesson of conventional public finance (Stiglitz 1988, and Musgrave and Musgrave 1989), the general principle is that in multi-jurisdictional units the allocation function depends on the geographical dimension of the benefit associated with the provision of a given public good. For goods and services with cross-jurisdictional negative externalities pushing towards central provision, allocation is a competence of the federal government. Conversely, when mapping the benefits accruing on to a given jurisdiction is possible, the allocation function belongs to that jurisdiction (Filippov, Ordeshook and Shvetsova 2004).

The distribution of taxing powers in the five federal countries reveals the following tendencies:

- (i) A system anchored on a *constitutional principle of concurrent powers between the federal, state and local levels*. The United States fits into this pattern (Eichengreen 1997).

All government tiers may intersect with each other when specific categories of taxes are considered. For example, both federal and states' governments are entitled to tax corporations and individuals' incomes (Stotsky and Sunley 1997). Concurrent powers are also the rule as far as indirect taxes is concerned, although here states are the prominent actor since they collect almost two thirds of indirect taxes (Seidel and Vesper 1999). Crucially, there is an overall balance between federal and non-federal taxes, considering that these amount to almost 50% of the total tax revenue in the United States (Bayoumi and Masson 1996). To a certain extent, this reveals how balanced the tax structure is. That aspect is enough to rule out the dominance of centralisation over decentralisation or the opposite.

Canada also matches these characteristics, despite some differences between the Canadian and the United States' tax structures. A system of concurrent powers between central and provinces' governments also prevails in Canada (Stevenson 2004). There is, however, a difference after analysing the outcome of the Canadian tax system: federal taxes account for roughly 50% of the United States' tax income when weighted on the total collection of taxes in both countries (Simeon and Robinson 2004). Two further dissimilarities with the United States' model emerge: indirect taxes are more important than social security payments; and within provinces, income and corporation taxes raise almost as much money as indirect taxes (Bayoumi and Masson 1996).

- (ii) *No rules about the distribution of taxing powers among different tiers of government:* Germany falls into this category.

In Germany, a strong federal government is largely influential in several issues. Consequently, the notion of 'unitary federation' comes to the surface (Spahn 1993). Despite this finding, the federal Constitution does not establish precise rules for the distribution of taxing powers (Seitz 2000). Therefore competences rest on the *Länder* unless otherwise is stated in the Constitution (Zimmermann 1999, and Gunlicks 2003).

Nonetheless, the word 'unless' encompasses many exceptions in the German constitutional context. In practice, what is taking place is a deformation of this functional principle. In fact, the *Länder* can legislate only if the federal government has not already legislated on that issue. There is evidence of tax issues been increasingly subject of federal legislation over the past forty years (Zimmermann 1999). Overall, the principle of shared competences is slightly more than dead wording. The practical consequences of the German system point to an opposite direction: on the one hand, a strict separation of fiscal competences between all tiers of government is noticed; and, on the other hand, the system exhibits a clearly centralisation bias (Seidel and Vesper 1999).

This judgment is not consistent with the idea that lower units of government act as executive agents of the federal government. By implication, central government's administrative powers are fading away because state and local governments perform significant administrative functions. For this reason Germany is the paradigm of central decision-making with decentralised execution (Spahn 1993, and Börzel 2003). This conclusion is valuable to understand the *status quo* in the European integration context (section 2).

- (iii) A third model is *a clear separation of taxing powers between the federal government and other levels of government*. Switzerland and Australia are included in this category, although they represent different outcomes as far as the centralisation/decentralisation continuum is concerned.

In Switzerland, the practical dimension of the so-called ‘tax jungle system’ (Dafflon 1999) makes it difficult to establish an unambiguous categorisation. The Swiss case, however, lays down clear guidelines on fiscal autonomy for the central, cantonal and local levels. Considerable tax competition between different cantons gives a further input to the confusion (Feld, Kirchgässner and Schaltegger 2003). Despite the breadth of tax powers assigned to the cantonal level, the rule allowing the central government to set limits on cantons’ total expenditures puts some constraints.

Australia is the most centralised example among these federations (Galligan and Wright 2002). The federal government collects 91% of total tax revenue (Spahn 1993). As a result, there is a huge imbalance between federal and states’ outlays and responsibilities, given that states fall short of revenues to meet all expenditures constitutionally assigned to them (Thorlakson 2003). Consequently, states largely depend upon transfers from the federal government – more than in any other country case under examination.

### **1.1. How (de)centralised are the five federations?**

The above analysis makes it possible to place all five federations along a continuum between centralisation and decentralisation. These five countries will be placed on the centralisation spectrum for the provision of public goods using Riker’s and Nathan’s methods (sections 1.1.2 and 1.1.3, respectively).

#### ***1.1.1. Surveying the distribution of tax competences***

Looking at the elements used above, the first exercise intends to put the five federal countries along the centralisation spectrum. Starting with the decentralisation pole – meaning *where decentralisation is more pronounced in relative terms* – Switzerland is the most decentralised federation as far as resource allocation is concerned. Then Canada follows in the decentralisation continuum. This federation is not as decentralised as Switzerland, but it is in any case more decentralised than the United States. Importantly, in the literature there are several examples building comparisons with the United States in order to interpret the functioning of the Canadian federation (for example, Bolleyer 2006). Considering the Australian federation the most

centralised case among the five countries (as it will be highlighted soon after), the next place in the centralisation continuum remains open to two countries, Germany and the United States. The comparison between both countries' federal elements, and particularly the provision of public goods and services by the federal government and lower units of government, feeds the idea that the United States is not as centralised as Germany.

In this respect, it is instructive to analyse how the powers of the federal government have been growing in these countries throughout the years. Scholars emphasise this is a characteristic that unites both the United States and Germany. Historically, these federations were more decentralised than today. This is clearly the case of the United States, where especially after 1965 creeping centralisation is taking place (with a minor retrocession during the Reagan administration) (Zimmerman 1992). A similar pattern has been widely reported in Germany, where central decision-making process is coupled with highly decentralised implementation. On this behalf, Germany offers mixed evidence of centralisation and decentralisation, thus locating it in between the extremes of the continuum.

Notwithstanding, Germany is perceived as a unitary federation (Benz 1999). In practice, the *Länder* are severely constrained to exercise their constitutionally guaranteed powers whenever the federal government has already produced legislation. Both aspects reveal a centralisation tendency coming to the surface. On the one hand, the qualification of Germany as a 'unitary federation' already encompasses the assumption of centralisation. On the other hand, the limits imposed to the *Länder* mean the central government benefits from the presumption to act. From the comparison between the United States and Germany, the former comes after Canada and precedes Germany in the centralisation continuum. In scaling down countries within the continuum, the United States lie in the middle while Germany comes up as the second most centralised federation.

The Australian federation is the champion of centralisation. The fact centralisation tendencies are more recognisable does not necessarily mean that Australia shows an extensive degree of centralisation. Indeed one crucial issue dealt by students of Australian federalism is to what extent states are at the mercy of the federal government (Spahn and Shah 1997). Despite the elements of centralisation found, several indicators reject the possibility of states being totally subordinated to the federal government

(Worthington and Dollery 2002): (i) general revenue grants mean 50% of state revenues and they are locked to quasi-constitutional rules; (ii) states' role is deeply rooted in the Constitution; (iii) the federal government is unable to cut all grants going to states; and (iv) in order to uphold political stability in the federation, the federal government is forced to reach an agreement with states' governments. In sum, '*(...) financial arrangements in Australia have been preserving and securing state independence and the lower tier of government is far from being at the mercy of the Commonwealth*' (Spahn 1993: 44-5).

For these reasons, the exercise of mapping down a centralisation/decentralisation scale must follow prudential standards. The idea that the most decentralised federation stands at the extreme of decentralisation while the most centralised federal reflects accentuated centralisation is not entirely accurate. *Relativism* is the keyword when conclusions on the mapping exercise are drawn. One federal country that comes at the top of centralisation does not equate absolute centralisation, only that it is *relatively* more centralised than other federal countries examined. The following illustration shapes this argument.

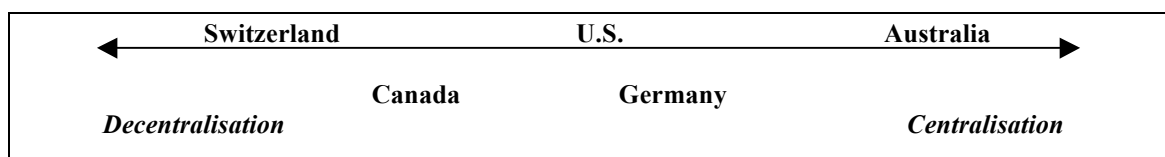


Fig 1: A scale of relative centralisation/decentralisation in five federal countries (first hypothesis)

### 1.1.2. The results using Riker's adjusted method

Reliable conclusions ask for alternative methods that shed empirical inputs to frame the picture of relative standings in the centralisation/decentralisation spectrum. Starting with Riker's method, a short note presents the aspects included in this method (Riker 1964: 123-35). The degree of decentralisation is measured by (a) the estimation of central governments' expenditures, (b) states' expenditures, and (c) local governments' expenditures. All three layers' expenditures are added to estimate the percentage of central government's total expenditures. *The lower this percentage is the higher the degree of decentralisation.*



*Table 1: Estimating the degree of centralisation in five federal countries according to Riker's method – percentage of federal government expenditures on total*

Country	Federal Government Expenditures	State and Local Government Expenditures	All Government Expenditures	Percentage of Federal Government Expenditures in Total
Australia	258,551(1)	163,978(1)	360,728(1)(a)	71.6%
Canada	229,460(2)	370,323(2)	599,783(2)	38.2%
Germany	801,980(3)	467,620(3)	1.061,230(3)(b)	75.5%
Switzerland	53,096(4)	117,532(4)	141,803(4)(c)	37.4%
United States	2,973.1(5)	2,065.5(5)	4,608.7(d)	64.5%
<b>Unweighed Average</b>	-	-	-	<b>57.4%</b>

Notes:

(1) Australian Government Finance Statistics, data for 2006-07 in millions of Australian Dollars. Source: Australian Bureau of Statistics (2008), assessed online at <http://www.abs.gov.au/ausstats/abs@.nsf/mf/5512.0> in 17.09.08.

(a) The total does not match with the sum of federal, state and local governments' expenditures due to an amount (14,588 Australian Dollars) belonging to the 'multi-jurisdictional sector'. According to the Australian Bureau of Statistics, this sector includes "(...) units where jurisdiction is shared between two or more governments, or classification of a unit to a jurisdiction [that] is otherwise unclear".

(2) Canada All Government Expenditures, data for 2007 in millions of Canadian Dollars. Source: Statistics Canada (2008), assessed online at <http://www.statcan.ca/english/freepub/68-213-XIE/68-213-XIE2008000.pdf> in 18.09.08.

(3) Expenditures of the overall public budget by levels, data for 2007 in millions of Euro. Sources: Eurostat (2008a), online at

[http://epp.eurostat.ec.europa.eu/portal/page?\\_pageid=1996.39140985&\\_dad=portal&\\_schema=PORTAL&screen=detailref&language=en&product=EU\\_MAIN\\_TREE&root=EU\\_MAIN\\_TREE/tb/t\\_economy/t\\_gov/t\\_gov\\_a/tec00023](http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996.39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=EU_MAIN_TREE&root=EU_MAIN_TREE/tb/t_economy/t_gov/t_gov_a/tec00023), assessed in 19.09.08, and Eurostat (2008b), online at

[http://epp.eurostat.ec.europa.eu/portal/page?\\_pageid=1996.39140985&\\_dad=portal&\\_schema=PORTAL&screen=detailref&language=en&product=EU\\_MAIN\\_TREE&root=EU\\_MAIN\\_TREE/tb/t\\_economy/t\\_na/t\\_nama/t\\_nama\\_gdp/tec00001](http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996.39140985&_dad=portal&_schema=PORTAL&screen=detailref&language=en&product=EU_MAIN_TREE&root=EU_MAIN_TREE/tb/t_economy/t_na/t_nama/t_nama_gdp/tec00001), assessed in 19.09.08.

(b) Adjusted for payments between different layer budgets, therefore adding-up is not possible.

(4) General Government Operations, data for 2006 in millions of Swiss Francs. Source: online at [http://www.efv.admin.ch/e/dokumentation/downloads/dokumentation/zahlen\\_fakten/statistik/SDDS\\_jahr-rechnung-schulden\\_en.pdf](http://www.efv.admin.ch/e/dokumentation/downloads/dokumentation/zahlen_fakten/statistik/SDDS_jahr-rechnung-schulden_en.pdf), assessed in 19.09.08.

(c) Certain categories of expenditure involve co-financing from different government levels. Thus, total government expenditure is not the mere addition of all government tiers' expenditures.

(5) United States All Government Consumption Expenditures, data for 2007 in billions of U.S. Dollars. Source: United States Census Bureau (2008).

(d) Certain categories of expenditure involve co-financing from different government levels. Thus, total government expenditure is not the mere addition of all government tiers' expenditures.

This method faces some limits since it only covers expenditures ignoring revenues. In fact, it is difficult to envisage state and local governments' autonomy without assigning some taxing powers to both government tiers. For that purpose, I suggest an extension of Riker's method to assess whether taxing powers are centralised or decentralised. To make this proposal readable in terms of the centralisation/decentralisation spectrum used in this method I measure the percentages achieved for both expenditure and revenue tables allowing an unweighed average that gives the so-called "centralisation index". The higher the index, the more centralised the countries is.

Table 2: A complement to Riker's method – measuring the percentage of federal government revenues in total (2005)

Country	State and Local Government Revenues (% of total)	Federal Government Revenues (% of total)	Centralisation index (1)
Australia	30.9	69.1	70.3
Canada	46.8	44.8	41.5
Germany	29.2	30.2	52.8
Switzerland	40.7	35.3	36.3
United States	34.2	41.1	52.8
<b>Unweighed Average</b>	<b>36.3</b>	<b>44.1</b>	<b>50.7</b>

Source: OECD (2007).

(1) The sum of the relative weight of federal governments' expenditures (the last column in table 1) and the relative weight of federal governments' revenues (second column in table 2) divided by two.

The observation of the results provided by what I would call 'adjusted Riker's method' deploys a slightly different centralisation/decentralisation scale.

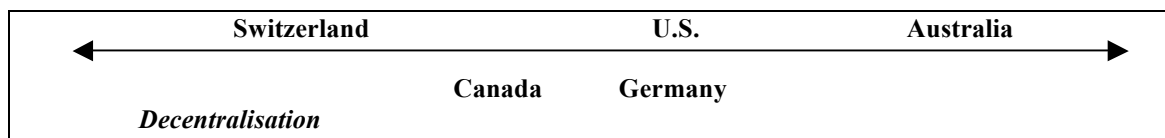


Fig. 2: A scale of relative centralisation/decentralisation in five federal countries (second hypothesis)

The relevant difference is fed by the same centralisation index of Germany and the United States, putting both countries on a overlapping position. In the first hypothesis (a qualitative one) Germany was more centralised than the United States. According to quantitative data based on revenue and expenditures across all government layers, both countries stand in the same position alongside the centralisation/decentralisation spectrum. Another instructive lesson is the awareness that none of these countries is totally centralised or decentralised. It would be surprising that full centralisation was the outcome after surveying statistical data, for centralisation does not match with federalism's genetic code. In fact federalism is more open to decentralisation nature, at least when its theoretical underpinnings are remembered (Rodden 2006: 31-32). The figures reveal that Switzerland, the most decentralised country, has an index of 36.3% (full decentralisation means a zero index) while Australia, the most centralised one, ranks 70.3% (centralisation means 100%).

The interesting conclusion is the awareness that federalism might mean different things when the balance between centralisation and decentralisation is at stake. The difference between Switzerland and Australia is remarkable. Figures can be interpreted as follows: in the Swiss (con)federation two thirds of fiscal competences are left to lower units of government; in the Australian federation, on the contrary, two thirds of fiscal competences (and thus the revenue for making resource allocation operational) are

granted to the federal level. Therefore, *federalism might have different meanings* when centralisation and decentralisation are at stake. *This provides support to the claim that there is not a single fiscal federalism, but instead distinct fiscal federalisms* (as the extension of the ‘many faces of federalism’ argument (Lenaerts 1990)). Such conclusion might prove useful for the feasibility of successful fiscal federalism in the EU.

### ***1.1.3. The results using Nathan’s method***

The third test returns to a combination of qualitative with quantitative measurement. The method borrows from Nathan’s analysis (Nathan 1992: 92-3) using a multi-dimensional framework with the following variables: (a) are lower government tiers autonomous to shape political institutions? (b) Are lower government tiers able to collect their own taxes? (c) Are lower government tiers the most important points of contact with citizens? (d) Do lower tiers possess important competences affecting citizens’ daily activities? (e) Are lower government tiers given a powerful say in national (federal) politics? (f) Do state governments perform a supervisory role towards local governments without any intrusion from the federal government?

To assess the five countries within this framework it is necessary to parameterise Nathan’s method variables. If the answer is affirmative in all six conditions, the expected outcome is an institutional setting consistent with a powerful say to lower tiers of government, thus a decentralised outcome.

Criterion	Australia	Canada	Germany	Switzerland	US	Average
States institutional autonomy	2	3	3	3	3	-
States’ taxing autonomy	1	2	1	2	2	-
Citizens loyalties mainly to states	2	2	2	3	2	-
States and citizens’ daily life	2	3	2	3	3	-
States’ say in federal politics	1	2	2	2	2	-
States supervise local governments	2	3	2	3	2	-
<b>Average results</b>	<b>1.7</b>	<b>2.5</b>	<b>2.0</b>	<b>2.7</b>	<b>2.3</b>	<b>2.24</b>

*Fig. 3: How decentralised are the five federal countries (using Nathan’s qualitative assessment)?*

I use the following notation for each of Nathan’s variables: either the federal country accomplishes that criterion (*Y – for Yes*), or stands halfway between accomplishment and absence (*I – for Indeterminacy*), or that criterion is absent (*N – for No*, or absent).

To quantify I suggest a score of 3 for Y, 2 for I, and 1 for N. After computing all the variables for each federal country, *the higher the result the more decentralised the country stands.*

The interpretation of these data paves the way for another exercise that deploys the five federal countries within the centralisation/decentralisation scale.

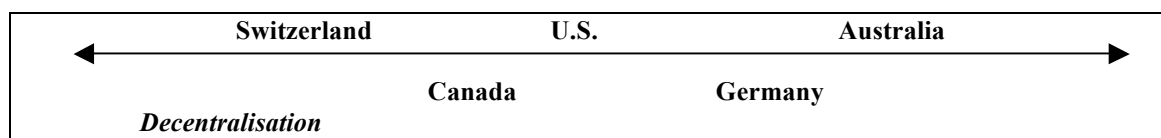


Fig. 4: A scale of relative centralisation/decentralisation in five federal countries (third hypothesis)

Federal countries' positions within the scale are the same as in the first continuum. Therefore, some continuity prevails in the three methods used to estimate where to place the five federal countries. More important than this range is the awareness that federal countries somewhat differ when placed alongside the continuum deploying how centralised/decentralised they are. This reveals different tendencies depending on the country under examination. When the allocation function is under scrutiny, some countries' federal system is heavily centralised, while in others decentralisation prevails.

The main lesson for European integration is the impossibility to draw robust inferences from a certain point alongside centralisation or decentralisation. Differentiation is the keyword. This exercise is also a useful building block if one claims that the EU cannot escape the lens of comparative studies. Like in all federal countries examined, the EU can also be measured in terms of centralisation/decentralisation and have its own place alongside the continuum of centralisation/decentralisation for the allocation function.

## 2. THE EUROPEAN UNION: A CASE OF DECENTRALISATION?

### 2.1. Resource allocation and European integration: basic principles

The methods used throughout the previous section provide an insight of resource allocation in the EU. At the same time, they are food for thought about the position of the EU in the centralisation/decentralisation continuum. Nevertheless, carrying over this task without precaution might involve some risks. The reason is the distinctiveness of the EU. Uniqueness does not imply the refutation of the comparative method. It is just a warning about the special nature of European integration that gave rise to a *sui generis* polity, somewhere in between a state and an international organisation (Koslowski 1999). Hence, it is difficult to draw oversimplified comparisons between the EU and

other federal countries. In fact, the EU, unlike other federal entities, is not a federal state. Therefore, a nuanced approach is required to capture the distinctiveness of European integration. By implication, some of the preceding methods' tools need to undergo adjustment to encompass the distinctiveness that shapes European integration.

For example, it is difficult to come out with strict comparisons between different budgetary levels in mature federations and the equivalent (at least in theory) levels in the EU. It might be inappropriate to put at the same hierarchical level the federal budget (in federal countries) and the EU budget (in the EU). Similarly, the analogy between states' budgets (in 'conventional fiscal federalism') and national budgets (in the EU) again involves a precautionary analysis. The reason for this warning is well documented in the writings highlighting European integration's diversity (Ardy and El-Agraa 2007). A similar levelling exercise might be illusory, for *different tasks belong to different budgetary levels in the EU and in federal countries*.

Table 3: Central government revenue in EU member states and comparison with EU budget revenues, 2007 (as % of GDP)

Country	Central Government Revenue (% of GDP) (1)
Austria	47.5
Bulgaria	41.2
Czech Republic	40.8
Belgium	48.7
Cyprus	42.7
Denmark	55.1
Estonia	36.9
Finland	52.7
France	49.9
Germany	43.9
Greece	40.2
Hungary	44.6
Ireland	36.7
Italy	46.6
Latvia	38.0
Lithuania	34.3
Luxembourg	41.2
Malta	40.7
Netherlands	46.3
Poland	40.4
Portugal	43.1
Romania	34.4
Slovenia	43.2
Slovakia	34.7
Spain	41.0
Sweden	56.0
United Kingdom	40.7
Unweighed average of EU member states	<b>43.0</b>
<i>EU Budget</i>	<b>0.93</b> (2)

(1) Source: European Commission (2008a), online at

[http://ec.europa.eu/economy\\_finance/publications/publication12832\\_en.pdf](http://ec.europa.eu/economy_finance/publications/publication12832_en.pdf), assessed in 24.09.08.

(2) Source: [http://eur-lex.europa.eu/budget/data/D2007\\_VOL1/EN/nmc-grseq42960935830-3/index.html](http://eur-lex.europa.eu/budget/data/D2007_VOL1/EN/nmc-grseq42960935830-3/index.html), assessed in 24.09.08.

The inspection of the EU public finances provides an analytical device to assess how the allocation function is accomplished. Three aspects supply the potential explanation for EU budget's inability to play a strong role in the allocation function (Hitiris 1994: 102). On the one hand, individual member states are still prominent actors in terms of budgetary politics (and policy). Secondly, widespread differentiation between member states' traditions on the provision of public goods and services also plays a role. Last but not the least, member states face different needs, which gave rise to a different composition of public goods and services' basket in each country. These are the *endogenous reasons*. Other reasons can be advanced (*exogenous reasons*), directly impacting upon endogenous motivations.

Low visibility is the crucial aspect that makes the supranational budget weaker. This holds for the comparison between the EU budget and member states' budgets in terms of revenue capacity, but also for the external comparison of the EU budget, i.e., when other federal countries' central budgets are examined and quantified. The implication is that the EU is unable to deliver public goods and services as federal budgets elsewhere do. It is important to be aware that the allocation function in federal countries is not necessarily a symptom of central competences. When the benefits from the provision of certain public goods or services match with state's geographical jurisdictions, the function is assigned to lower tiers of government. The federal government is entitled with a general competence to fund and/or provide public goods and services with nation-wide interests (as well as other goods and services where the federal level captured a competence in the meantime).

The main lesson from 'conventional fiscal federalism' is that the federal and lower tiers of government share the burden of providing public goods and services. Resource allocation does not belong only to a certain government level. To a certain extent, the EU falls into this category although supranational budget's revenue is very limited to meet resource allocation goals – at least when the comparison between the EU budget and its counterpart in federal countries (central budgets) comes to the surface.

The EU budget co-funds certain public goods, notably those designed to promote intra-EU regional cohesion. These public goods, categorised for purposes of EU regional policy, involve competence sharing between the EU and member states (Martin 1999,

and Armstrong 2007). Shared competences are the baseline for the comparison between the EU and other federations for purposes of resource allocation. Problem-solving intensity assigned to the EU budget is, however, much lower than the role performed by other countries' federal budget. This results from the combination of endogenous and exogenous factors previously emphasised in this section.

## 2.2. The EU in the centralisation/decentralisation spectrum

I will use the three previous methods for estimating how the EU fits into the centralisation/decentralisation continuum when compared against the federations examined. For that purpose I use all the tables from section 1 (keeping all the notes and sources that were mentioned there), with the difference that each table comes added with data for the EU.

*Table 4: Estimating the extent of centralisation in five federal countries and the EU according to Riker's method – percentage of federal government expenditures in total*

Country	Federal Government Expenditures	State and Local Government Expenditures	All Government Expenditures	Percentage of Federal Government Expenditures in Total
Australia	258,551	163,978	360,728	71.6%
Canada	229,460	370,323	599,783	38.2%
Germany	801,980	467,620	1,061,230	75.5%
Switzerland	53,096	117,532	141,803	37.4%
United States	2,973.1	2,065.5	4,608.7	64.5%
<b>European Union</b>	<b>115.4(1)(a)</b>	<b>5,309.3(2)(a)</b>	<b>5,424.7</b>	<b>2.1%</b>
<b>Unweighed Average Without the EU (and with the EU)</b>	-	-	-	<b>57.4% (48.2%)</b>

(1) Source: [http://eur-lex.europa.eu/budget/data/D2007\\_VOL1/EN/nmc-grseq42960935830-3/index.html](http://eur-lex.europa.eu/budget/data/D2007_VOL1/EN/nmc-grseq42960935830-3/index.html), assessed in 24.09.08.

(2) Source: European Commission (2008b), online at [http://ec.europa.eu/economy\\_finance/indicators/annual\\_macro\\_economic\\_database/ameco\\_applet.htm](http://ec.europa.eu/economy_finance/indicators/annual_macro_economic_database/ameco_applet.htm), assessed in 24.09.08.

(a) Figures in billions Euros, data for 2007.

*Table 5: A complement to Riker's method – measuring the percentage of federal government and the EU budget revenues in total*

Country	State and Local Government Revenues (% of total)	Federal Government Revenues (% of total)	Centralisation index (1)
Australia	30.9	69.1	70.3
Canada	46.8	44.8	41.5
Germany	29.2	30.2	52.8
Switzerland	40.7	35.3	36.3
United States	34.2	41.1	52.8
<b>European Union</b>	<b>98.0(1)(a)</b>	<b>2.0(2)(a)</b>	<b>2.1</b>
<b>Unweighed Average Without the EU (and with the EU)</b>	<b>36.3 (46.6)</b>	<b>44.1 (37.0)</b>	<b>50.7 (42.6)</b>

(1) Source: European Commission (2008b), online at [http://ec.europa.eu/economy\\_finance/indicators/annual\\_macro\\_economic\\_database/ameco\\_applet.htm](http://ec.europa.eu/economy_finance/indicators/annual_macro_economic_database/ameco_applet.htm), assessed in 24.09.08.

(2) Source: [http://eur-lex.europa.eu/budget/data/D2007\\_VOL1/EN/nmc-grseq42960935830-3/index.html](http://eur-lex.europa.eu/budget/data/D2007_VOL1/EN/nmc-grseq42960935830-3/index.html), assessed in 24.09.08.

(a) Data for 2007.

Turning to the complement of Riker's method, in order to provide an overall picture addressing both items within all layers of budgetary power, I estimated revenues' relative weight. The same exercise was done for the EU, according to the data depicted in table 5, above. Standing in line with the results of the 'Riker-adjusted method', and taken the other federal countries are as benchmarks, figure 5 plots the EU within the centralisation/decentralisation scale.

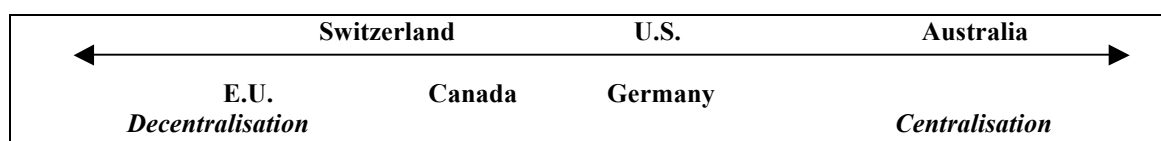


Fig. 5: A scale of relative centralisation/decentralisation in five federal countries and the EU (using 'Riker's-adjusted method')

Turning to Nathan's method, another version of fig. 3 directly compares the figures associated with the EU and the data already known for the other federations.

Table 6: How decentralised are the five federal countries and the EU (using Nathan's qualitative assessment)?

Criterion	Australia	Canada	Germany	Switzerl.	US	EU	Average
States institutional autonomy	2	3	3	3	3	<b>3</b>	-
States' taxing autonomy	1	2	1	2	2	<b>3</b>	-
Citizens loyalties mainly to states	2	2	2	3	2	<b>3</b>	-
States and citizens' daily life	2	3	2	3	3	<b>2</b>	-
States' say in federal politics	1	2	2	2	2	<b>2</b>	-
States supervise local governments	2	3	2	3	2	<b>3</b>	-
<b>Average results</b>	<b>1.7</b>	<b>2.5</b>	<b>2.0</b>	<b>2.7</b>	<b>2.3</b>	<b>2.7</b>	<b>(2.24) 2.32</b>

As it happened with the foregoing method, the next step consists of deploying the results into the scale that ranks the continuum between centralisation and decentralisation for concluding whether the position of the EU is different when assessed through both methods.

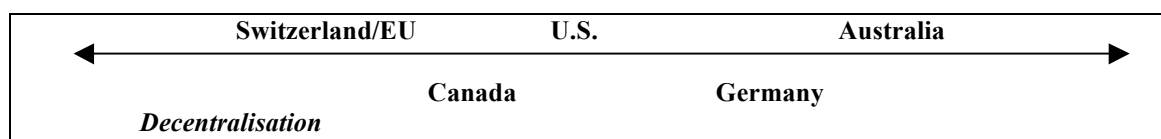


Fig. 6: A scale of relative centralisation/decentralisation in five federal countries and the EU (using Nathan's method)



Comparing figures 5 and 6, the difference (looking only to the inclusion of the EU in the scale) is that while according to ‘Riker’s adjusted method’ the EU is the most decentralised case among the countries observed, figure 6 positions the EU and Switzerland roughly at the same decentralisation standard. Nevertheless, it stands out clear that the EU ranks far more decentralised than the remaining federations.

*All the evidence suggests that the EU is a case of decentralisation.* One explanation lies on endogenous aspects stemming from the powerful differentiation among member states and the deep-rooted sense of nationhood within member states (but not at the supranational level). Exogenous aspects supply the second explanation. They result from endogenous aspects and act as a powerful constraint on a more ambitious EU budget that creates a hard to remove ceiling. For these reasons, the EU has intrinsic federal elements and lies at the pole of decentralisation when compared with the other federations alongside the centralisation/decentralisation continuum.

#### **CONCLUSION: IS THERE A PLACE FOR MORE CENTRALISED ALLOCATION IN THE EUROPEAN UNION?**

Aside from this positive analysis, a normative question touches the future of European integration: *do further developments in European integration call more centralisation, i.e., more supranational provision of public goods that currently fall under national budgets?* As a follow-up of this question, one might wonder if, strictly from the angle of resource allocation, the EU is prepared to assemble the basic features of ‘conventional fiscal federalism’.

Before elaborating on the issue, it is important to realise a contradiction that might arise from the previous premise. Large sectors of the literature make a clear connection between fiscal federalism and centralisation (Von Hagen 1993: 267-9, Alesina, Perotti and Spolaore 1995: 752, Rosen 1995: 516-9, Laffan 1997: 28-9, and Kletzer 1999: 114). This understanding is not consistent with the empirical assessment undertaken in section one, where data suggested centralisation is not necessarily equated with ‘conventional fiscal federalism’ (at least for the allocation function). Hence, according to proponents of ‘conventional fiscal federalism’, the EU should be closer to other federations in terms of resource allocation. Correspondingly, a rightwards shift of the EU alongside the decentralisation/centralisation continuum towards an intermediate position would emerge.

Is it feasible, under the current conditions of European integration, to envisage a centralisation leap of resource allocation in the EU? Three reasons deny the centralisation scenario. Firstly, creeping centralisation requires a change in the current political climate, notably the convergence of national governments' preferences towards increasing EU budget own resources. Without fulfilling this condition, EU's ability to play a stronger role in resource allocation is hampered.

Two obstacles play a huge influence against further centralisation of resource allocation. On the one hand, on the previous multi-annual financial framework (Agenda 2000) member states showed their unwillingness to increase the EU budget revenues (Galloway 1999, and Koester and El-Agraa 2007). On the other hand, the 2004-2007 enlargement added another hurdle to the goal of increasing the EU budget because member states and supranational institutions bargained an outcome of zero increase for budget outlays. Negotiations about multi-annual financial perspectives for 2007-13 showed deep divergences between national representatives, as the press has repeatedly reported<sup>1</sup>.

The second aspect is the awareness that a solution that gives more powers to the supranational tier entails a political and economic incongruity. Economically speaking, centralisation clashes against the principle of assigning public goods' provision to the lowest government tier, especially when it is easy to find out the territorial delimitation of benefits. More importantly, centralisation runs against subsidiarity, one building block of European integration. To envisage the EU budget increasingly funding public goods goes against the belief that supranational bureaucrats are far away from places where problems are tangible and affect peoples' daily life. Supranational bureaucrats' increasing interference paves the way for unreasonable solutions, since some decisions regarding the provision of public goods might involve a myopic assessment of local populations' needs.

Politically, increased centralisation in the EU clashes against what is going on worldwide. Considering that national governments lost crucial macroeconomic tolls from the beginning of EMU, a further shrinking of economic policy powers seems infeasible. Furthermore, one cannot ignore an important political aspect: some doubts arise about the legitimacy of the supranational decision-making process, at least when viewed from conventional, state-centric parameters, (Caporaso 1996, and Eriksen and

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<sup>1</sup> EUObserver, 22 June 2004, online at <http://www.euobserver.com/?sid=9&aid=16688>.

Fossum 2000). Hence, national governments have a powerful incentive to keep at home the large bulk of decisions concerning the provision of public goods. On the one hand, national politicians avoid losing another important ingredient of economic governance. On the other hand, they see themselves as the primary source of loyalty vis-à-vis citizens (Buiter 1999, and Stone Sweet, Fligstein, and Sandholtz 2001). *These economic and political motivations suggest that reinforced centralisation in the EU is infeasible.*

Thirdly, a related argument comes to the surface: the lack of solidarity among member states of the EU prevents the growth of supranational budget's resources. The peoples of Europe are perceived to be largely divorced from European integration (Bellamy and Castiglione, 2000). One method of assessing this aspect is to examine peoples' perceptions of European integration. Table 7 provides a rough measure, giving information of where citizens look at when they seek solutions for their problems.

*Table 7: Feeling attached to a place (1995/2005)*

<b>Member State</b>	<b>Region 1995/2005</b>	<b>Country 1995/2005</b>	<b>The EC/EU 1995/2005</b>
Austria	3.7/92%	3.5/94%	2.3/66%
Belgium	3.5/84%	3.2/80%	2.5/72%
Czech Republic	---/81%	---/90%	---/74%
Cyprus	---/86%	---/97%	---/32%
Denmark	3.4/77%	3.7/97%	2.1/74%
Estonia	---/77%	---/92%	---/44%
Finland	3.2/90%	3.6/97%	2.0/74%
France	3.4/83%	3.4/93%	2.6/64%
Germany	3.6/88%	3.3/87%	2.3/66%
Greece	3.9/96%	3.9/97%	2.4/44%
Hungary	---/88%	---/96%	---/92%
Ireland	3.6/93%	3.7/96%	2.5/66%
Italy	3.4/89%	3.5/92%	2.7/75%
Latvia	---/84%	---/90%	---/56%
Lithuania	---/80%	---/90%	---/42%
Luxembourg	---/82%	---/91%	---/82%
Malta	---/76%	---/95%	---/62%
Netherlands	3.1/72%	3.1/83%	2.1/57%
Poland	---/92%	---/97%	---/83%
Portugal	3.7/94%	3.7/97%	2.5/55%
Spain	3.6/89%	3.5/90%	2.4/64%
Slovakia	---/84%	---/86%	---/67%
Slovenia	---/91%	---/95%	---/73%
Sweden	3.4/88%	3.6/93%	1.9/79%
United Kingdom	3.3/86%	3.4/88%	2.1/47%
<b>EC/EU unweighted average</b>	<b>3.5/87%</b>	<b>3.4/91%</b>	<b>2.4/66%</b>

Sources:

1) Data for 1995 adapted from Hooghe and Marks (2001: 55), Table 3.1. (Methodological note: Question: People may feel different degrees of attachment to their region, to their country, or to the EC. Please tell how attached do you feel to...? The data were adjusted from a larger survey where different answers were envisaged for measuring how attached people felt to these three hypothesis: 'very attached' (code 4), 'fairly attached (code 3)', 'not very attached' (code 2), and 'not at all attached' (code 1)).

2) Data for 2005 in European Commission (2005a: 111-112).

The examination of 1995 data shows that people were more concerned with their own problems, turning the attention to the regional or the national level of decision-making. The attachment to domestic layers is significantly higher in all member states. For both layers the answers rank near the higher code of attachment (“very attached”). This data contrasts with the way respondents feel attached to the EU: the average is 2.4, somewhere in between the “not very attached” and the “fairly attached” categories. There are interesting variations across member states. In some member states the degree of attachment towards the EU is closer to code 2 (Denmark, Finland, the Netherlands, Sweden and the United Kingdom), meaning that they are not particularly committed to European integration. Conversely, only one member state (Italy) shows a result close to code 3, showing a commitment to the EU that almost ranks the level of “fairly attachment”. The interesting finding here is that the lower level of enthusiasm and involvement with European integration is located at the north of the EU territory.

Data for 2005 do not follow the same methodology. They score a country-by-country average attachment (per cent) to the several layers involved in EU politics. The 2005 poll reproduces the long-lasting tendency of people fundamentally attached to their member state, or even region, and not so much to the EU. The average of member states’ attachment towards the EU (66%) is much lower than the one that shows peoples’ commitment towards their home countries (91%). Interestingly, heterogeneity emerges following a cross-country data examination. The degree of attachment to the EU varies from 32% (Cyprus) to 92% (Hungary). Thus, dispersion increased by comparison with the 1995 poll. Only five member states present a degree of attachment to the EU higher than 75%. Maybe it is bewildering that some of the newest member states rank in the bottom five of the scale (Cyprus, Lithuania, and Estonia).

The data are instructive of how their neighbours’ problems are not among citizens’ priorities. It is not surprising that the deepening of European integration was not followed by the development of a common civic identity (Chryssochoou, 2003: 380) that was necessary to forge inter-state solidarity. Moreover, Eurobarometer surveys show that persons drive their loyalties to a national (if not sub-national) level and not to the supranational dimension. Table 8 corroborates the aforementioned reasoning.

Table 8: European versus national identity 1992 to 2005, EC12/EU15/EU25

	<b>EB 37 (Spring 1992)</b>	<b>EB 44 (Spring 1995)</b>	<b>EB 49 (Spring 1998)</b>	<b>EB 57 (Spring 2002)</b>	<b>EB 64 (Autumn 2005)</b>
Only nationality	38	40	44	38	41
Nationality and European	48	46	41	48	48
European and nationality	7	6	6	7	7
Only European	4	5	5	4	2

Sources:

1) Data from Eurobarometer 37, 44, and 49 in McKay (1999: 167). Data for 2002 in European Commission (2002), Table 4.5.

2) Data for 2005 in European Commission (2005b: 46).

There is a sharp difference between two broad categories of behaviour: on the one hand, persons who find themselves only national or recognise their nationality comes before European identity; on the other hand, those who put “Europeaness” above nationality, or even the more radical ones who consider themselves only Europeans. Polls show a stable pattern over time when both categories are compared. Throughout the years, the “pro-European identity” peaked 11 points at best. Instead of finding out a growing perception of “pro-European identity”, recent data shows the opposite: it decreased from 11 to 9 points in 2005, which breaks the stable pattern observed throughout the time series. Conversely, “national identity” ranked on unprecedented levels (89 points). From this perspective, it stands clear how national identity comes after European identity (for a large distance).

Absent inter-state solidarity is powerful obstacle to an ambitious provision of public goods at the supranational level. What is the reason of member states’ political unwillingness to increase EU budget revenues? The answer lies in the awareness of reciprocal links falling short of an embedded political community similar to mature federations. In fact, there are no political conditions for anticipating a transfer of competences from the national towards the supranational level. Furthermore, decisions taken by a national government are democratically legitimate for those who live in that country, not by the remaining member states’ citizens.

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