The Economics of European Integration

Chapter 3

Decision Making

Task allocation and subsidiarity

- Key question: "Which level of government is responsible for each task?"
  - Setting foreign policy
  - Speed limits
  - School curriculum
  - Trade policy, etc
- Typical levels:
  - local
  - regional
  - national
  - EU
- Task allocation = 'competencies' in EU jargon

Subsidiarity principle

- Before looking at the theory, what is the practice in EU?
- Task allocation in EU guided by subsidiarity principle (Maastricht Treaty)
  - Decisions should be made as close to the people as possible,
  - EU should not take action unless doing so is more effective than action taken at national, regional or local level.
- Background: "creeping compentencies"
  - Range of task where EU policy matters was expanding.
  - Some Member States wanted to discipline this spread.

3 Pillars and task allocation

- 3 Pillar structure delimits range of:
  - Community competencies (tasks allocated to EU).
  - Shared competencies (areas were task are split between EU and member states).
  - National competencies.
- 1st pillar is EU competency.
- 2nd and 3rd are generally national competencies
  - details complex, but basically members pursue cooperation but do not transfer sovereignty to EU.

Theory: Fiscal federalism

- What is optimal allocation of tasks?
- Basic theoretical approach is called Fiscal Federalism.
  - Name comes from the study a taxation, especially which taxes should be set at the national vs sub-national level.

Fiscal federalism: The basic trade-offs

- ## What is optimal allocation of tasks
  - NB: there is no clear answer from theory, just of list of trade-offs to be considered.
- ## Diversity and local informational advantages
  - Diversity of preference and local conditions argues for setting policy at low level (i.e. close to people).
- ## Scale economies
  - Tends to favour centralisation and one-size-fits-all to lower costs.
- ## Spillovers
  - Negative and positive spillovers argue for centralisation.
    - Local governments tend to underappreciated the impact (positive or negative) on other jurisdictions. (Passing Parade parable).
- ## Democracy as a control mechanism
  - Favours decentralisation so voters have finer choices.
- ## Jurisdictional competition
  - Favours decentralisation to allow voters a choice.

Diversity and local information

- ## Closer look at the trade-offs

- One-size-fits-all policies tend to be inefficient since too much for some and too little for others.

- central government could set different local policies but Local Government likely to have an information advantage.
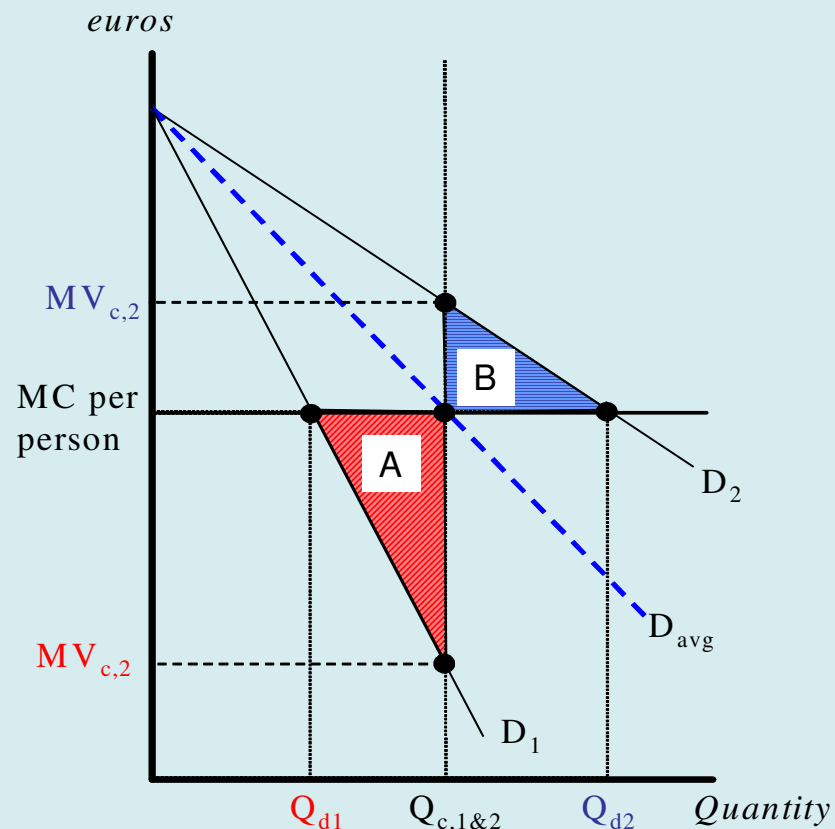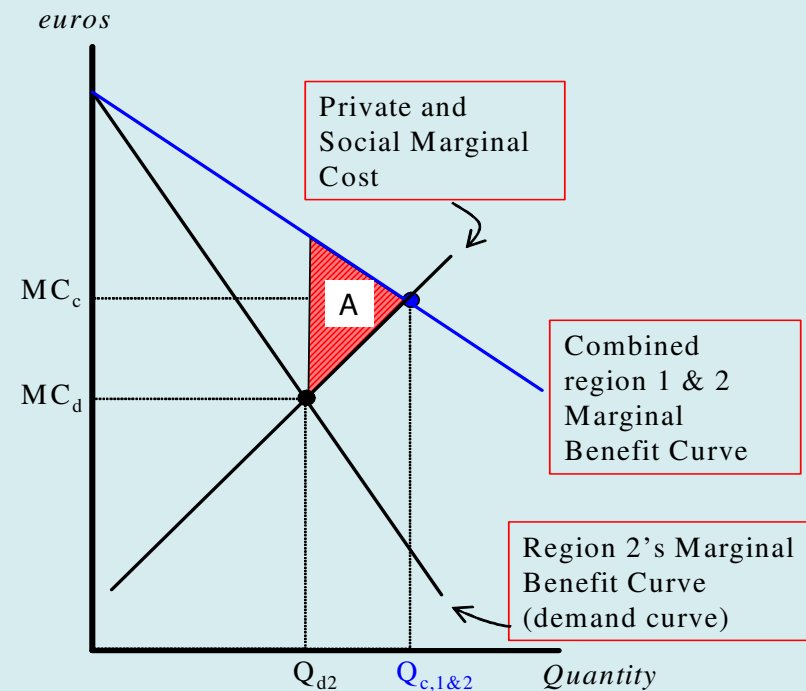
Scale

- By producing public good at higher scale, or applying to more people may lower average cost.

- This ends to favour centralisation.

  – Hard to think of examples of this in the EU.
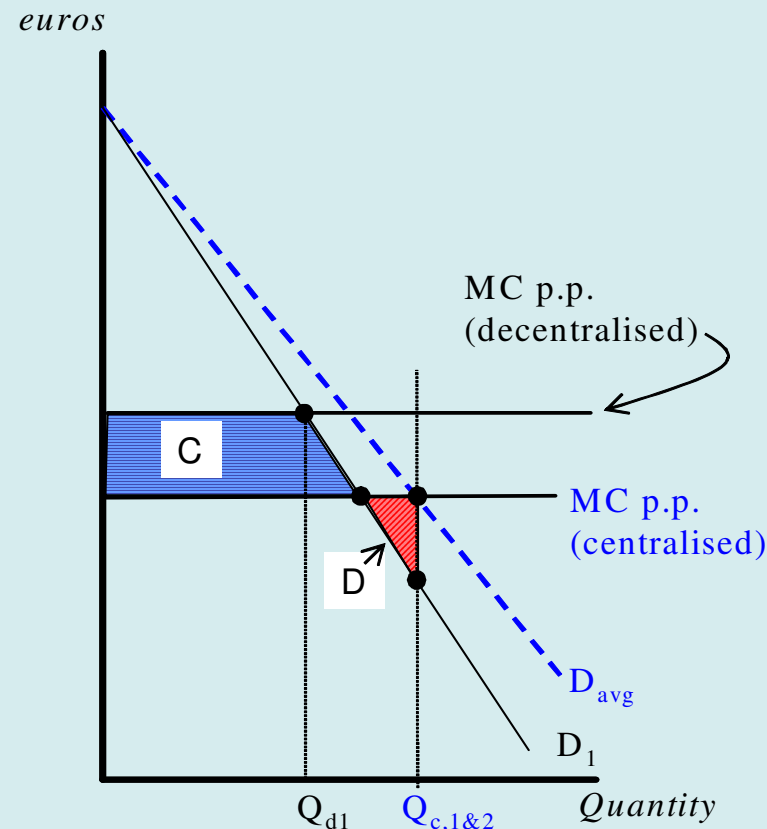
Spillovers

- Example of a positive spillovers.

- If decentralised, each region chooses level of public good that is too low.
  - e.g. Q_{d2} for region 2.

- Two-region gain from centralisation is area A.

- Similar conclusion if negative spillovers.
  - Q too high with decentralised.

euros

Private and Social Marginal Cost

Combined region 1 & 2 Marginal Benefit Curve

Region 2's Marginal Benefit Curve (demand curve)

MC_c

A

MC_d

Q_{d2} $Q_{c,1\&2}$ *Quantity*

Democracy as a control mechanism

- If policy is in hands of local officials and these are elected, then citizens' votes have more precise control over what politicians do.

- High level elections are take-it-over-leave-it for many issues since only a handful of choices between 'promise packages' (parties/candidates) and many, many issues.
  - Example of such packages:
    - Foreign policy & Economic policy.
    - Centre-right's package vs Centre-left's package.
    - At national level, can't choose Centre-right's economics and Centre-left's foreign policy.

McGraw Hill Education

Jurisdictional competition

- Voters influence government they live under via:
  - 'voice'
    - Voting, lobbying, etc.
  - 'exit'.
    - Change jurisdictions (e.g. move between cities).
- While exit is not a option for most voters at the national level, it usually is at the sub-national level. And more so for firms.
  - Since people/firms can move, politicians must pay closer attention to the wishes of the people.
  - With centralised policy making, this pressure evaporates.

McGraw Hill Education

Economical view of decision making

- Using theory to think about EU institutional reforms.
    - e.g., Institutional changes in Constitutional Treaty, Nice Treaty, etc.
- Take enlargement-related EU institutional reform as example.

EU enlargement challenges

- Since 1994 Eastern enlargement was inevitable & EU institutional reform required.
  - 3 C's: CAP, Cohesion & Control.
  - Here the focus is on Control, i.e. decision making.
- Endpoint: EU leaders accepted the Constitutional Treaty June 2004.
- Look Nice Treaty and Constitutional Treaty.
  - Nice Treaty is in force now and will remain in force until new Treaty is ratified.
- Focus on Council of Ministers voting rules.
  - See Chapter 2; these are the key part of EU decision making.

Voting rules

- Voting rules can be complex, especially as number of voters rises.
- Number of yes-no coalitions is 2^n.
  - Example: All combinations of yes & no votes with 3 voters Mr A, Mrs B, and Dr C;
- Example: EU9 when Giscard d'Estaing was President of France.
  - 512 possible coalitions.
- When Giscard considered Constitutional Treaty rules, it was for at least 27 members:
  - 134 million coalitions.

Yes	No
A, B, C	
A, B	C
A	B, C
B,C	A
C	A,B
	ABC
A, C	B
B	A,C

2 Formal Measures

- 1. "Passage Probability" measures 'Decision making efficiency'.
  - Ability to act
- 2. Normalise Banzhaf Index measure Power distribution among members.
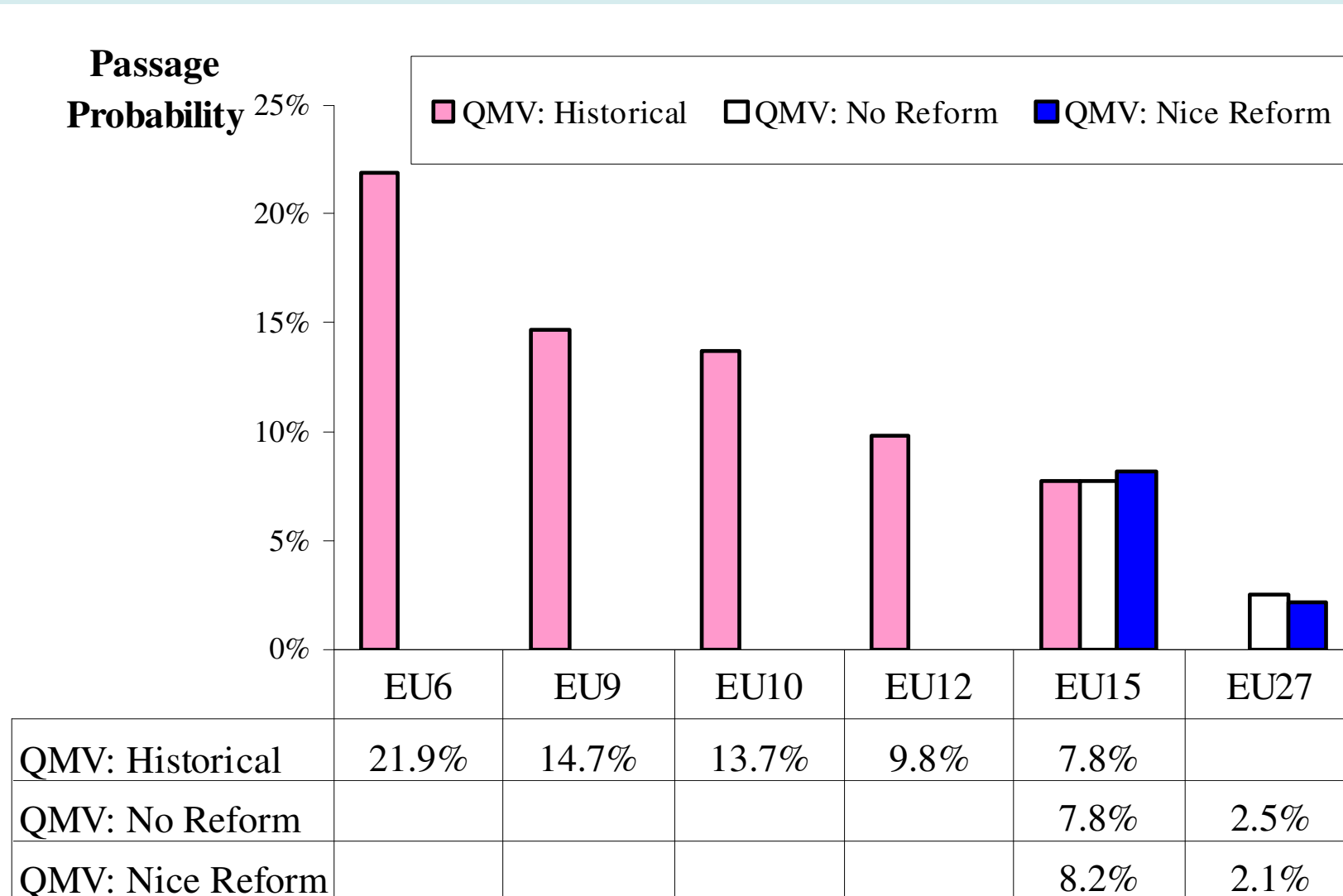 - Many others are possible

Passage probability explained

- Passage probability is ratio of two numbers:
  - Numerator is total number of winning coalitions.
  - Denominator is total number of coalitions.
- Passage probability equals probability of win <u>if</u> all coalitions are equally likely.
  - Idea is that for a 'random' proposal, all coalitions equally likely.
  - Nations don't know in advance whether they will 'yes' or 'no.'
- Caveats: This is a very imperfect measure.
  - Not random proposals,
- But, still useful as measure of change in decision-making efficiency.

Nice reforms: 1 step forward, 2 steps backward

- Step Forward:

  – Re-weighting improves decision-making efficiency.

- 2 Steps Backwards:

  – 2 new majority criteria worsens efficiency.

  – raising vote threshold worsens efficiency.

- The ways to block in Council massively increased.

  – EU decision-making extremely difficult.

- Main point is Vote Threshold raised.

  – Pop & member criteria almost never matter.

    - About 20 times out of 2.7 million winning coalitions.

  – Even small increases in threshold around 70% lowers passage probability a lot.

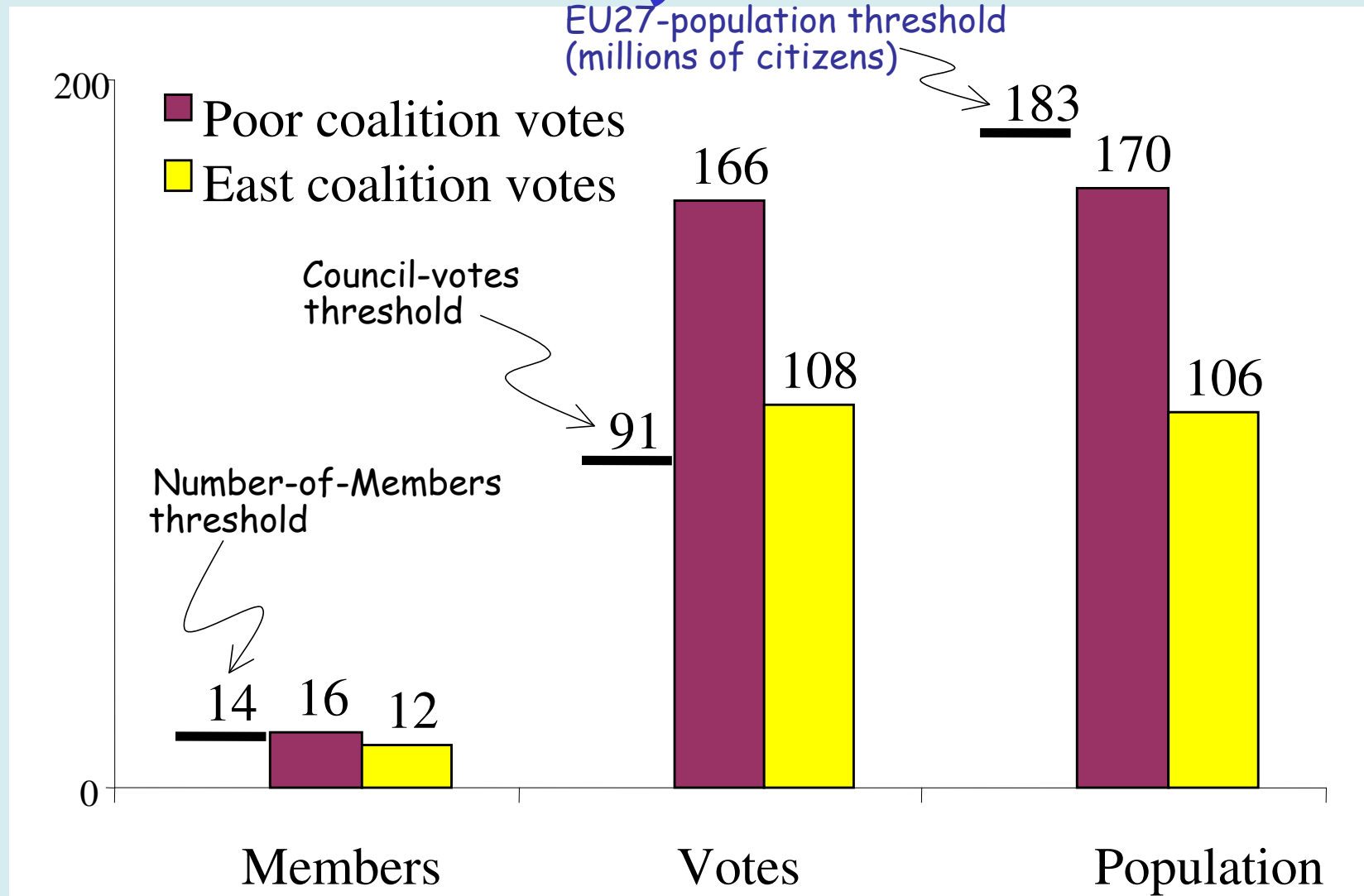   - The number of blocking coalitions expands rapidly compared to the number of winning coalitions.

Historical Passage Probabilities

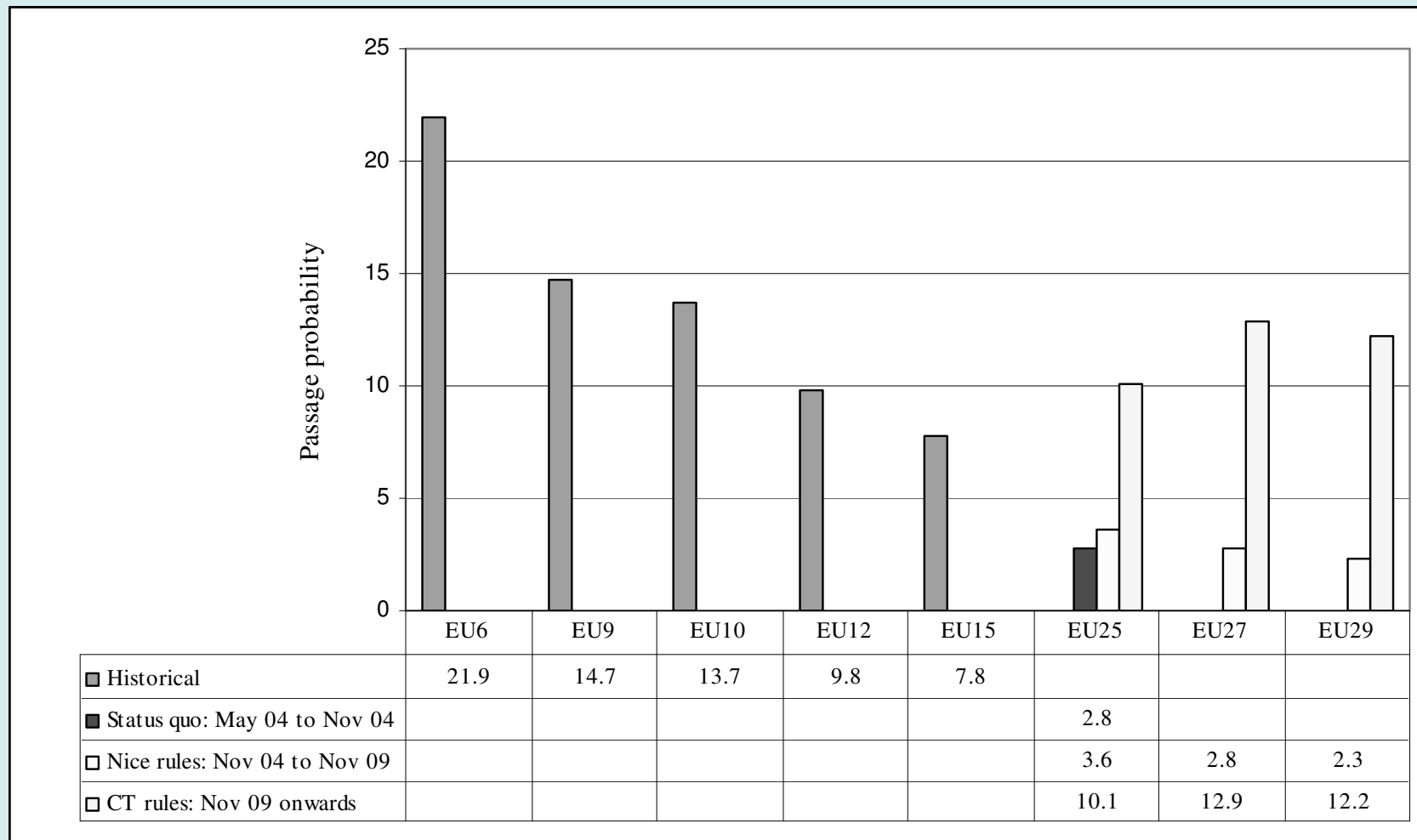|	EU6	EU9	EU10	EU12	EU15	EU27
QMV: Historical	21.9%	14.7%	13.7%	9.8%	7.8%	
QMV: No Reform					7.8%	2.5%
QMV: Nice Reform					8.2%	2.1%

Less formal analysis

- Blocking coalitions.
- Easier to think about & probably what most EU leaders used.
- Try to project likely coalitions and their power to block.
- For example, coalition of "Newcomers" & coalition of "Poor".

Examples: 2 blocking coalitions, Nice rules

Constitutional Treaty rules very efficient

	EU6	EU9	EU10	EU12	EU15	EU25	EU27	EU29
■ Historical	21.9	14.7	13.7	9.8	7.8			
■ Status quo: May 04 to Nov 04						2.8		
□ Nice rules: Nov 04 to Nov 09						3.6	2.8	2.3
□ CT rules: Nov 09 onwards						10.1	12.9	12.2

Passage probability

•Source: Baldwin & Widgren (2005)

Power measures

- Formal power measures:
- Power = probability of making or breaking a winning coalition.
  - SSI = power to make.
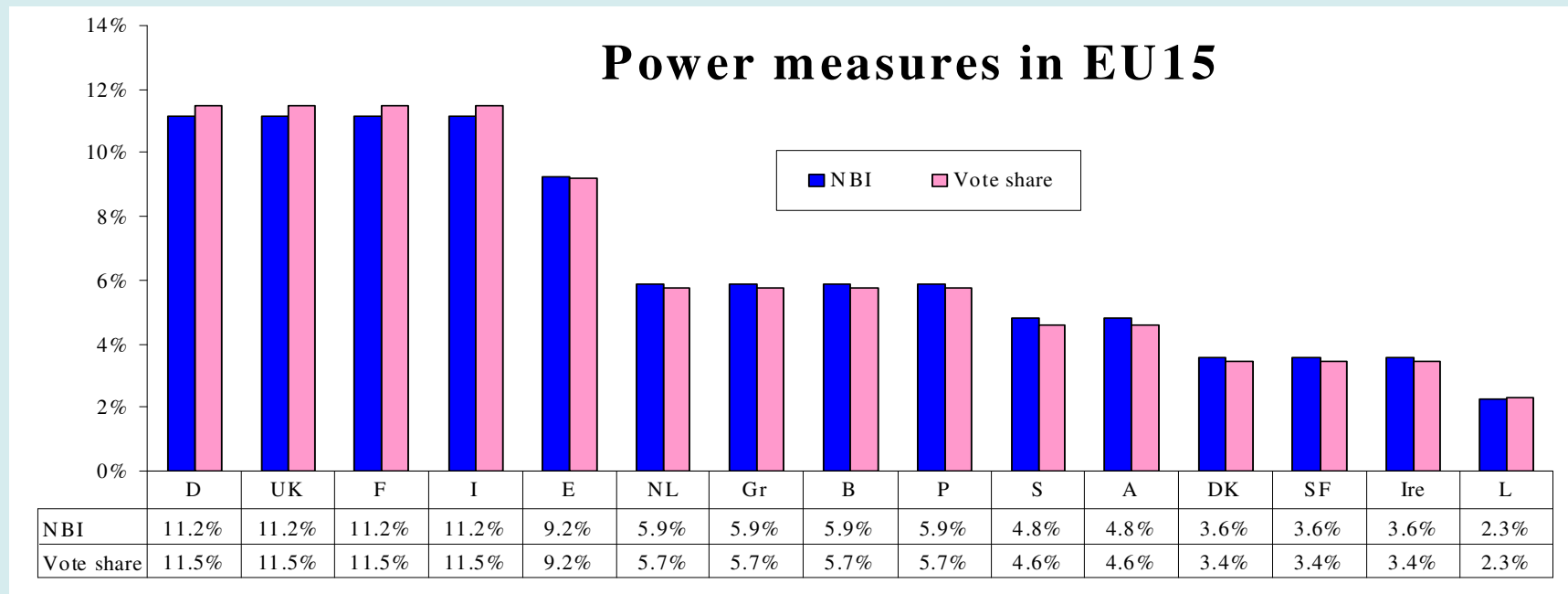 - NBI = power to break.
- Focus on the NBI.

  In words, NBI is a Member's share of swing votes.
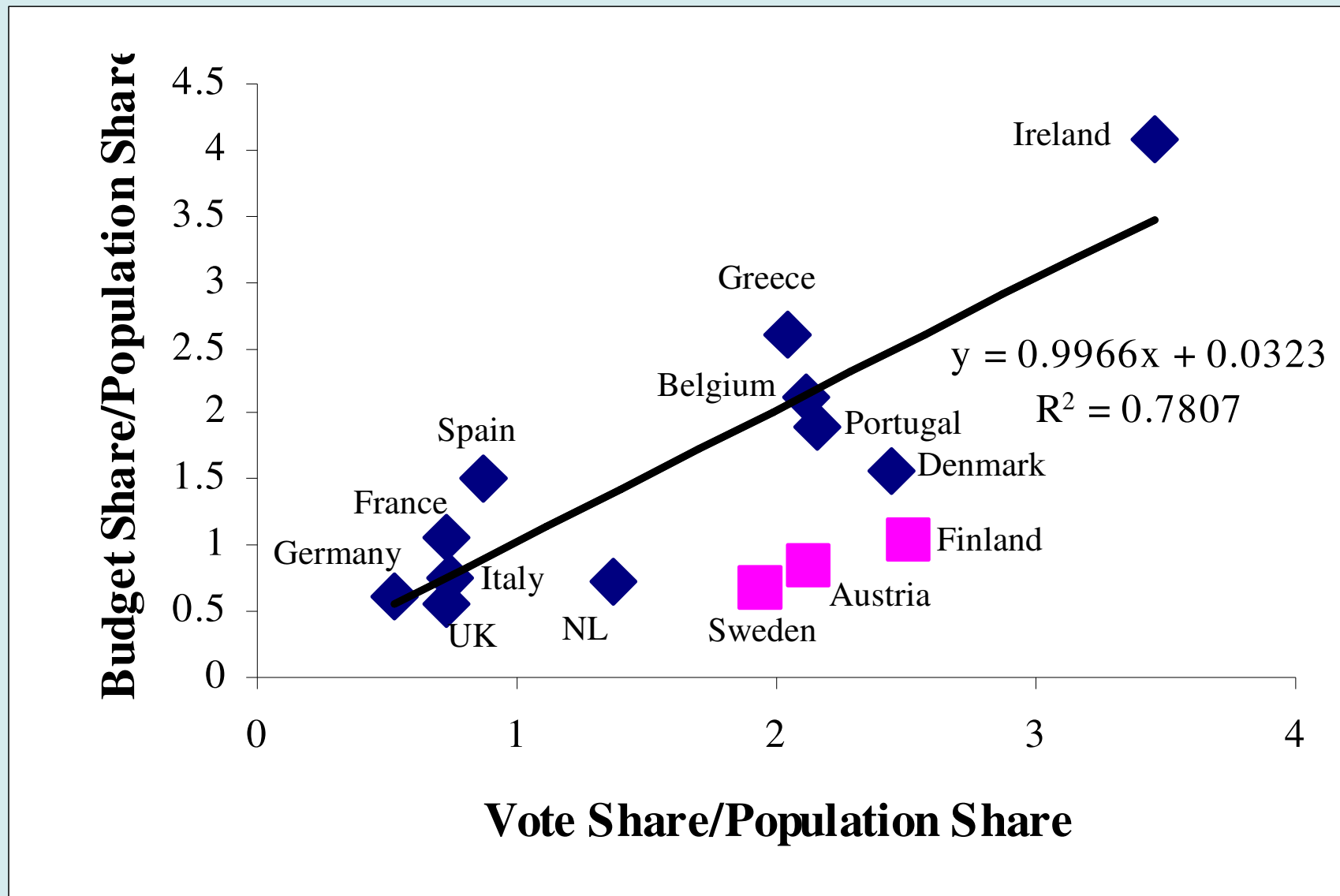
ASIDE: Power measures

- Why use fancy, formal power measures?
- Why not use vote shares?
  - Simple counter example: 3 voters, A, B & C
  - A = 40 votes, B=40 votes, C=20 votes
  - Need 50% of votes to win.
- All equally powerful!
- Next, suppose majority threshold rises to 80 votes.
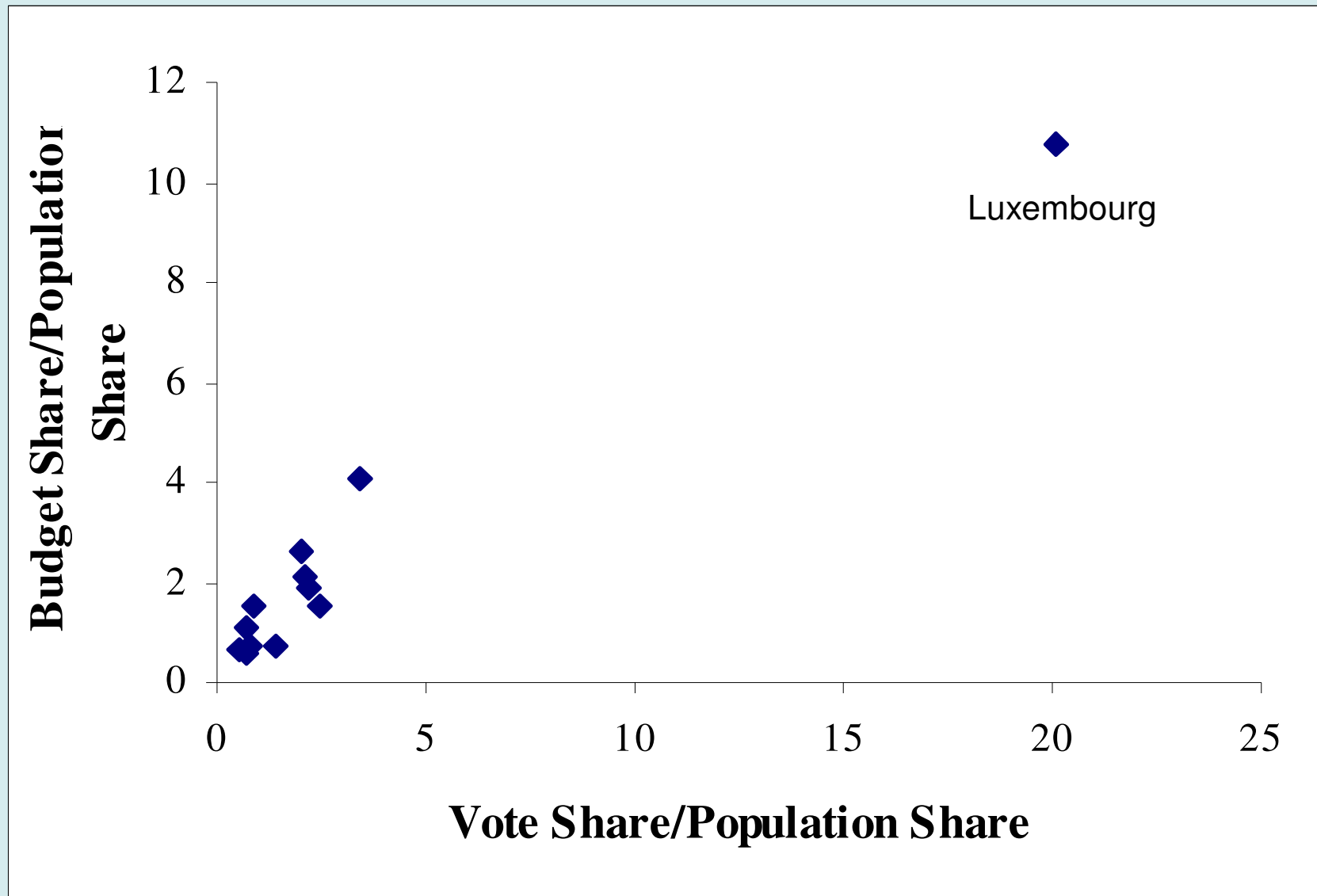 - C loses all power.

Distribution of power among EU members

- For EU15, NBI is very similar to share of Council votes, so the distinction is not so important as in 3 country example.
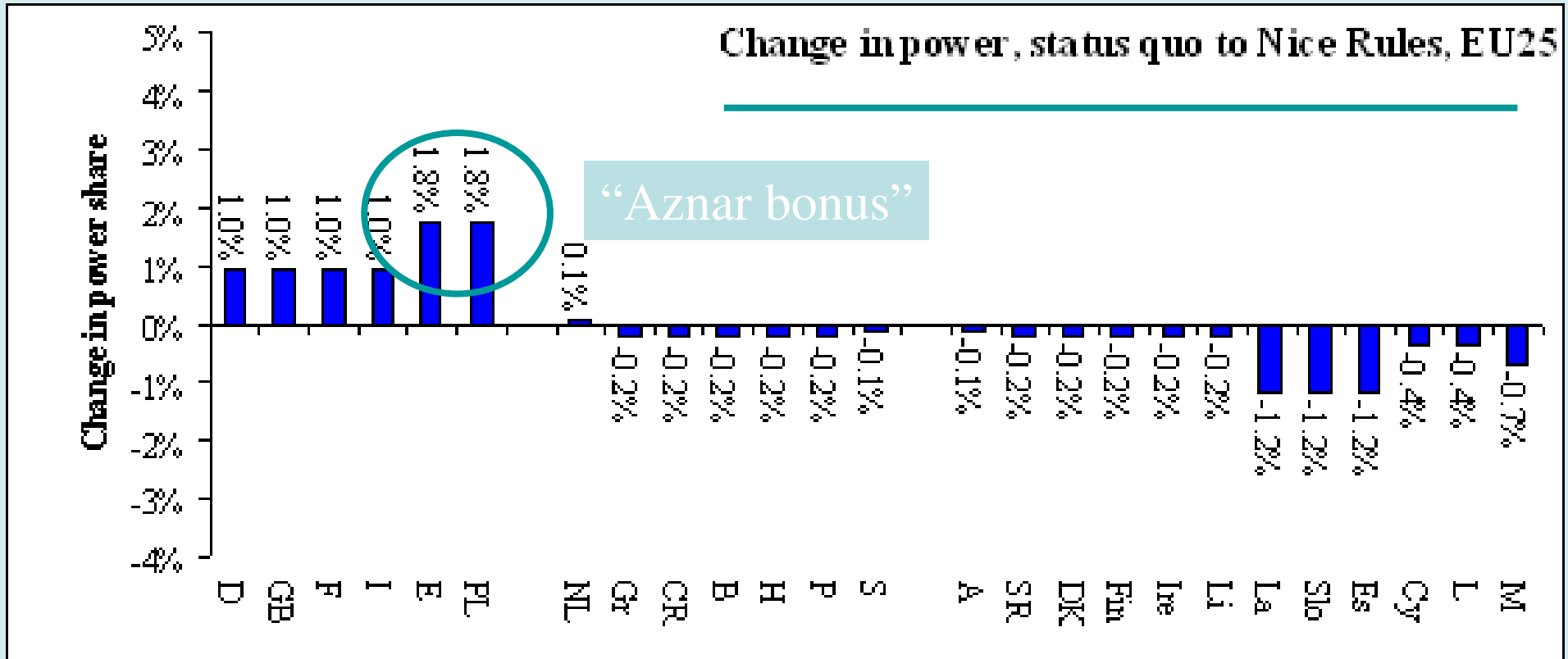
Power measures in EU15

	D	UK	F	I	E	NL	Gr	B	P	S	A	DK	SF	Ire	L
NBI	11.2%	11.2%	11.2%	11.2%	9.2%	5.9%	5.9%	5.9%	5.9%	4.8%	4.8%	3.6%	3.6%	3.6%	2.3%
Vote share	11.5%	11.5%	11.5%	11.5%	9.2%	5.7%	5.7%	5.7%	5.7%	4.6%	4.6%	3.4%	3.4%	3.4%	2.3%

Legend: ■ NBI ■ Vote share

Do power measures matter?

$$y = 0.9966x + 0.0323$$
$$R^2 = 0.7807$$

Budget Share/Population Share (vertical axis)

Vote Share/Population Share (horizontal axis)

Labels: Ireland, Greece, Belgium, Portugal, Denmark, Spain, France, Germany, Italy, UK, NL, Finland, Austria, Sweden

Do power measures matter?

Winners & Losers from Nice

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Impact of Constitution rules

- Change in power in EU-25, Nice to CT rules, %-points

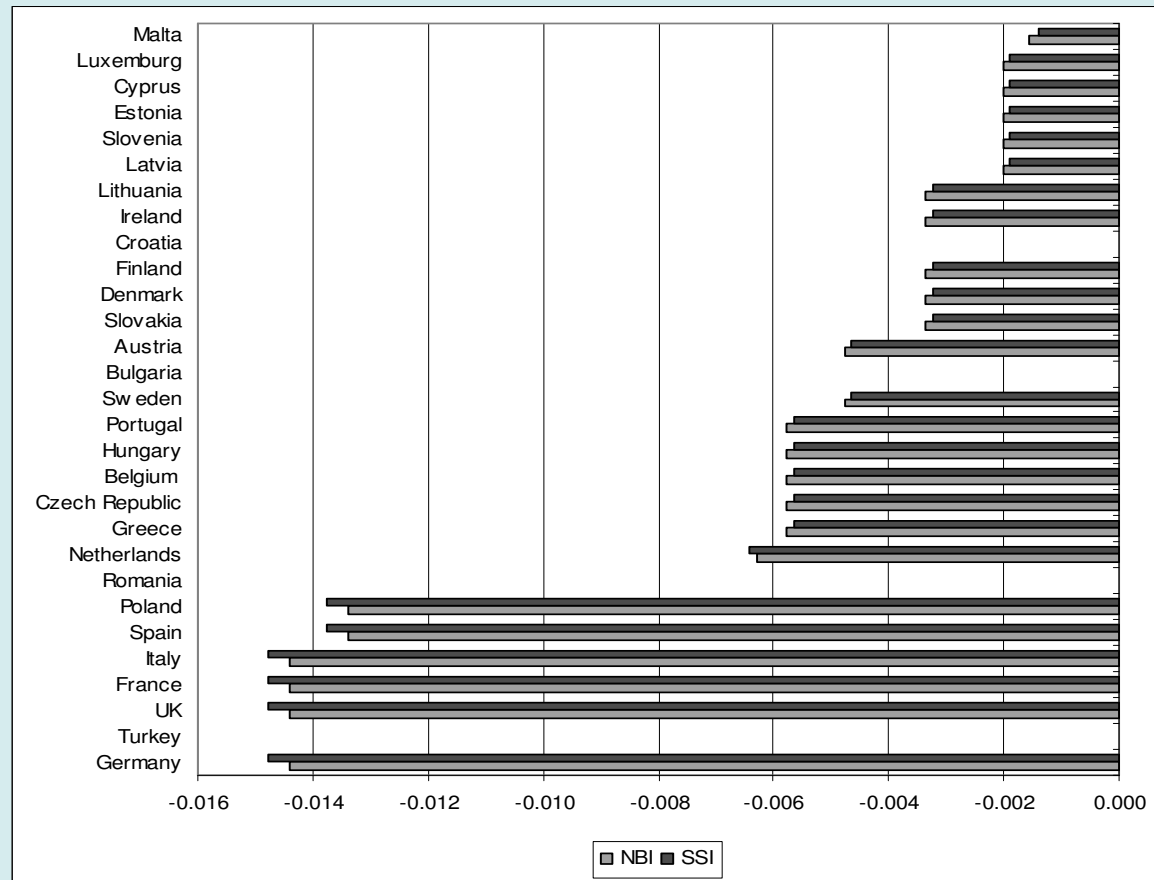•Source: Baldwin & Widgren (2005)

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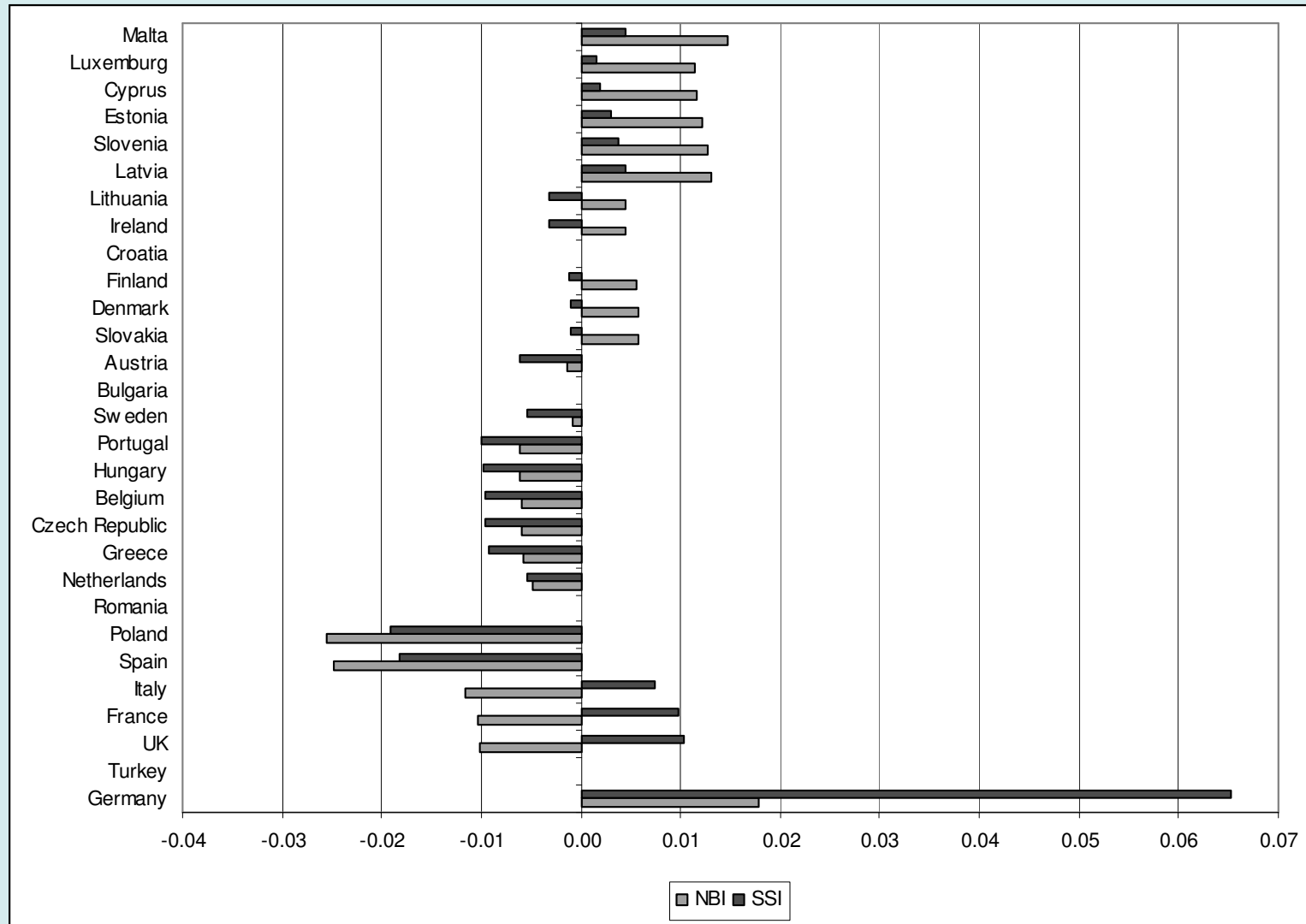
Impact of Constitution rules

- *Power change CT and Nice rules in EU-29, %-points*
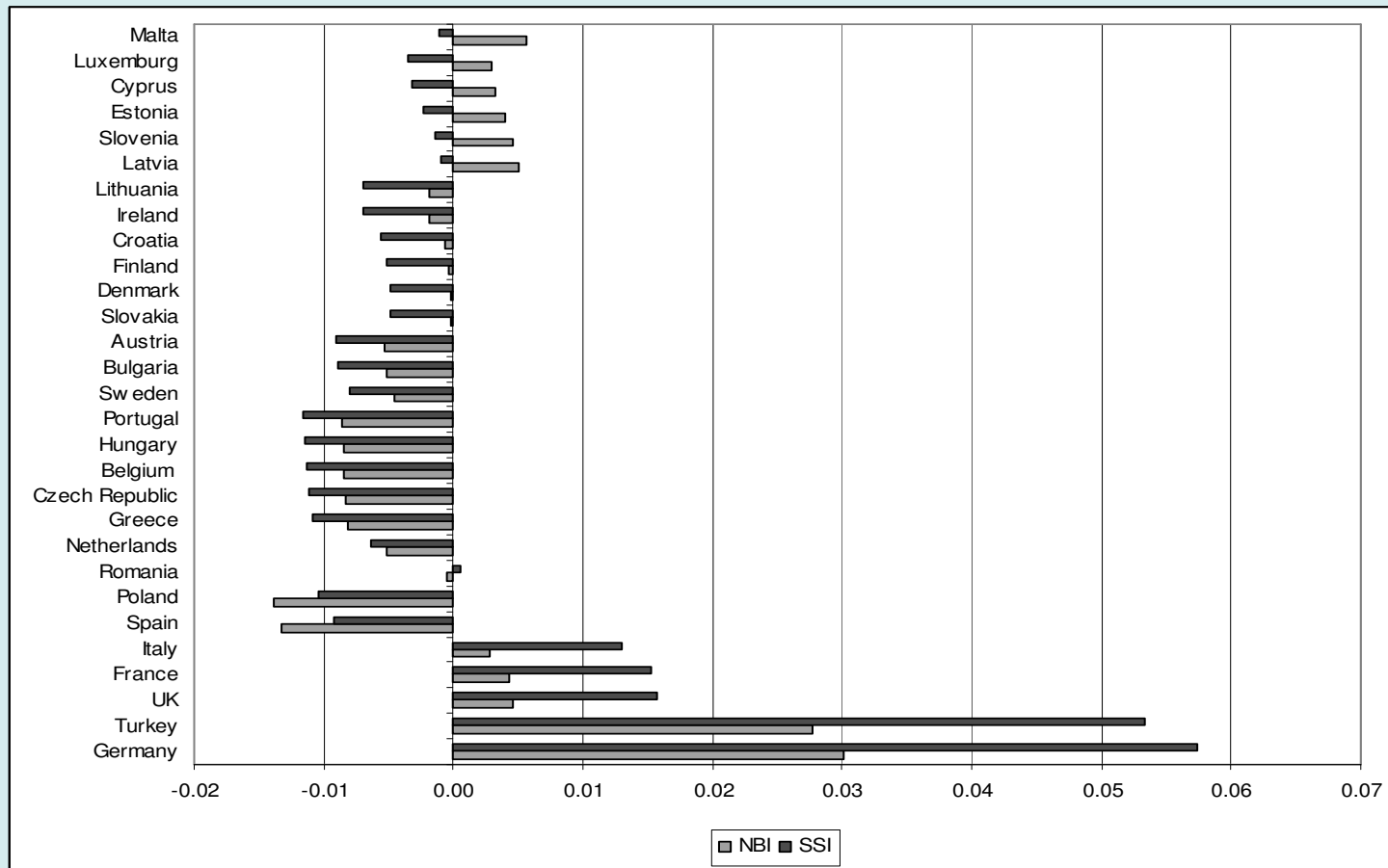
Impact of Constitution rules

- Enlargement's impact on EU25 power, %-points, Nice rules
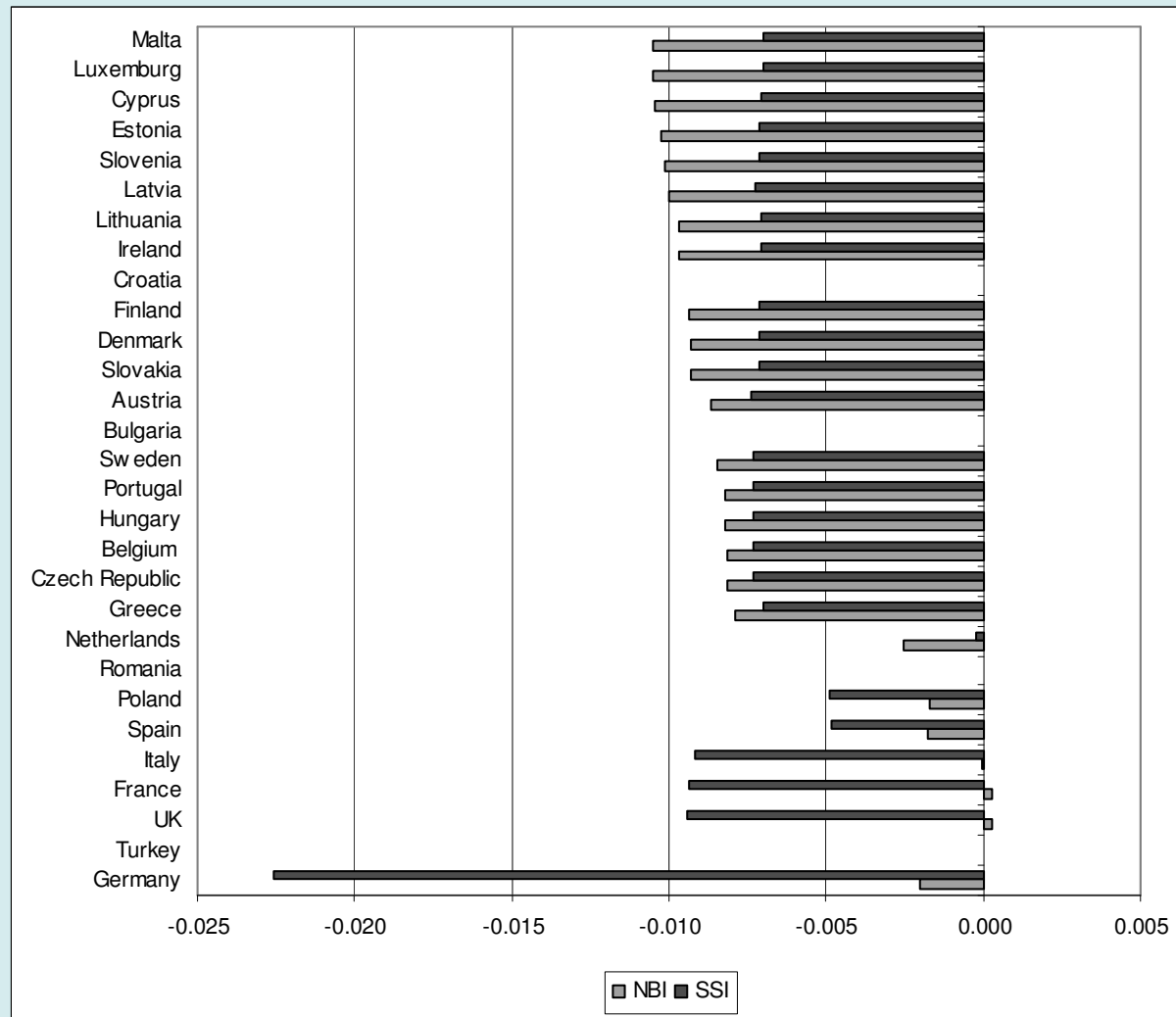

•Source: Baldwin & Widgren (2005)

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Impact of Constitution rules

- Enlargement's impact on EU25 power, %-points, CT rules

Legitimacy in EU decision making

- Legitimacy is slippery concept.
  - Approach: equal power per citizen is legitimate 'fair'.
- Fairness & square-ness.
  - Subtle maths shows that equal power per EU citizen requires Council votes to be proportional to square root of national populations.
- Intuition for this:
  - EU is a two-step procedure
    - Citizens elect national governments,
    - These vote in the Council.
  - Typical Frenchwoman is less likely to be influential in national election than a Dane.
  - So French minister needs more votes in Council to equalise likelihood of any single French voter being influential (power).
  - How much more?
  - Maths of voting says it should be the square root of national population.

Voting rules in the CT

- Three sets of rules
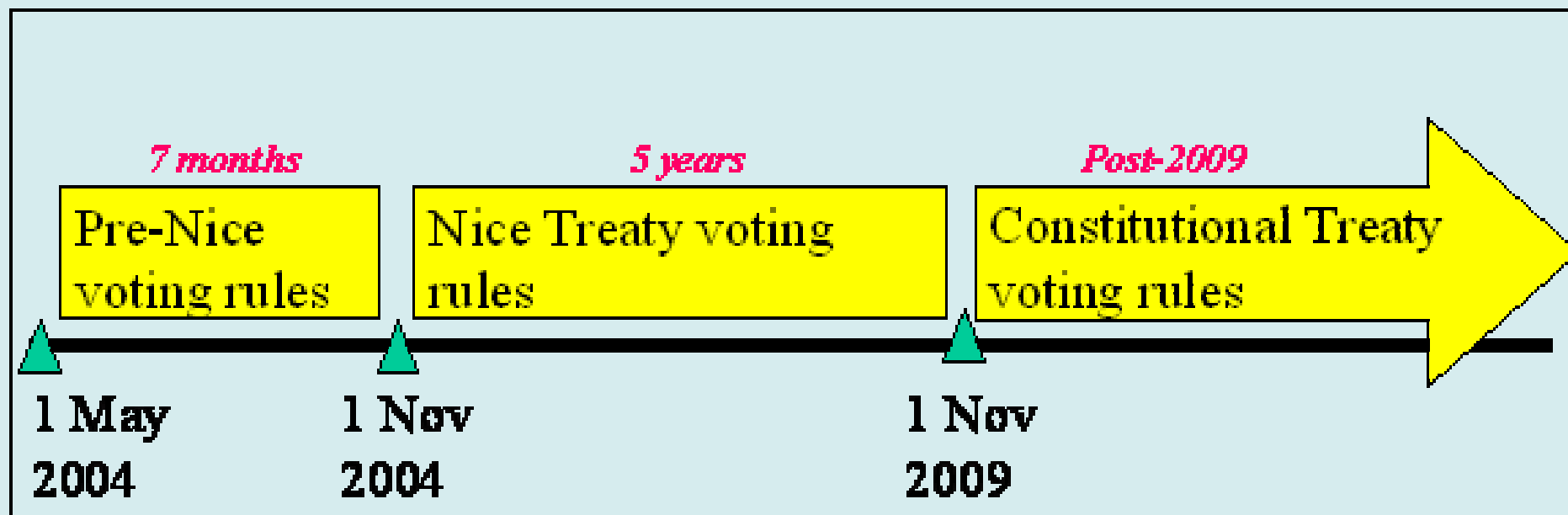
Pre-Nice Treaty Voting Rules

- No longer used since 1 November 2004, but important as a basis of comparison.

- "Qualified Majority Voting" (QMV):
  - 'weighted voting' in place since 1958,
  - Each member has number of votes,
  - Populous members more votes, but far less than population-proportional.
    - e.g. Germany 10, Luxembourg 2
  - Majority threshold about 71% of votes to win.

Nice Treaty Voting Rules

- 3 main changes for Council of Ministers:
- Maintained 'weighted voting'.
  - Majority threshold raised.
- Votes re-weighted.
  - Big & 'near-big' members gain a lot of weight.
- Added 2 new majority criteria:
  - Population (62%) and members (50%).
- ERGO, triple majority system.
  - Hybrid of 'Double Majority' & Standard QMV.

Post Nov 2009 rules

- If the Constitution is ratified, then New system after November 2009: Double Majority.

- Approve requires 'yes' votes of a coalition of members that represent at least:
    - 55% of members,
    - 65% of EU population.

- Aside: Last minute change introduced a minimum of 15 members to approve, but this is irrelevant.
    - By 2009, EU will be 27 and 0.55*27=14.85
    - i.e. 15 members to win anyway.