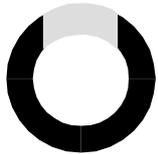


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Institut für Allgemeine Wirtschaftsforschung  
Abteilung für Wirtschaftspolitik

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**Functional Federalism: Communal or Individual Rights?**  
**On B. S. Frey's and R. Eichenberger's Proposal for a "New Federalism"<sup>1</sup>**

by  
Viktor J. Vanberg

If there is one theme central to economics it is, no doubt, the notion of competition as a social organizational device that can induce self-interested agents to seek to be of service to other persons for whose wellbeing they do not feel any genuine concern. Traditionally economists have focused on how market competition induces profit-oriented suppliers of ordinary goods and services to be responsive to consumer interests. It is only in more recent decades that systematic efforts have been made to extend the logic of Adam Smith's invisible-hand argument beyond the market realm and to study how competition may serve a similar function in politics. If competition in markets can help to promote consumer sovereignty, one began to ask, can it not equally help to promote citizen sovereignty, that is, can it not serve to make self-interested politicians and government bureaucrats, the suppliers of public services, more responsive to citizens' interest.

Economists have developed their inquiry into the role of competition in politics along two lines that, using A.O. Hirschman's (1970) terms, one may contrast as *voice* and *exit*. On the one hand there is what may be called the Downs-tradition,<sup>2</sup> concentrating on *electoral competition* or competition for votes among candidates or parties. On the other hand there is the Tiebout-tradition<sup>3</sup> that concentrates on *spatial competition* among local governments for residents-taxpayers. Research in both traditions supports the sobering conclusion that, compared to the disciplining force of market competition, the competition for votes as well as the competition for mobile residents are of much more limited effectiveness in inducing governments to be responsive to their citizens' interests. Accordingly, much of the attention has come to concentrate on the issue of how, i.e. by what kinds of institutional provisions, competition in politics may be made more effective, both in its voice- and in its exit-dimension.

The book by Bruno S. Frey and Reiner Eichenberger that is to be reviewed here belongs in the context of this general debate.

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<sup>1</sup> Frey, Bruno S., and Reiner Eichenberger (1999), *The New Democratic Federalism for Europe - Functional, Overlapping and Competing Jurisdictions*. Cheltenham, UK/Northampton, MA, USA: Edward Elgar. 111 pp. £ 39.95. ISBN 1-84064-004-9.

<sup>2</sup> Named after the pioneering contribution of Anthony Downs (1957)

<sup>3</sup> Initiated by Charles M. Tiebout (1956).

## 1. Responsive Government and FOCJ

"The New Democratic Federalism for Europe" is meant as an exercise in applied constitutional economics. Starting from the premise that the "purpose of government is to fulfil the needs of the citizens" (p. ix)<sup>4</sup> the authors inquire into how the rules of the game of politics might be improved to serve that purpose better. As they emphasize, their approach is "process-oriented" (p. 4). It is about the process in which political outcomes are generated, not about outcomes as such. The authors' concern is with how the political process ought to be organized if the likelihood is to be increased that citizens are provided, in the most efficient manner, with the kinds of public services that they want, whatever that may be.

As Frey and Eichenberger (from hereon: F&E) note at the very outset of their study, in their view "two institutions have proved to be excellent in fulfilling this task: federalism and direct democracy" (p. ix). The declared purpose of their book is to outline an institutional arrangement that can strengthen "the existing aspects of federalism and direct democracy" (ibid.). Accordingly, they want the institutional innovation that they propose, they call it FOCJ (Functional Overlapping Competing Jurisdictions), to combine two features. On the one hand, it is supposed to strengthen the voice-option by assigning a larger role to elements of direct democracy, such as popular referenda and initiatives. On the other hand, it is designed to strengthen the exit-option by replacing or supplementing the traditional structure of *territorial* federalism by a *functional* federalism. - Even though F&E stress that their FOCJ concept integrates both aspects, direct democracy and functional federalism, it is clearly the second aspect that they pay most attention to, and it is on this aspect of their proposal that the following discussion will largely concentrate.

In Part I of their book F&E present the general idea of their FOCJ concept (chpt. 1), describe the advantages of FOCJ as suppliers of local public goods (chpt. 2), explain how FOCJ are to be implemented and governed (chpt. 3), compare the FOCJ concept to similar approaches such as Tiebout's model of spatial competition and J.M. Buchanan's (1965) club theory (chpt. 4), contrast it to other proposals for institutional reforms such as G. Tullock's (1994) sociological federalism, and discuss historical as well as contemporary examples of institutions that share certain features with FOCJ, like "citizen communes" in Switzerland or "special districts" in the USA. In Part II the concept is applied to "Federalism in today's Europe." After a brief summary of the existing institutional structure of the EU and a review of other proposals for institutional reform (chpt. 6) the authors describe how the FOCJ device could be implemented in the EU and how it might help to alleviate problems that the current

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<sup>4</sup> The page number in the text refer to the book under review.

institutional structure appears ill-equipped to handle (chpt. 7). Finally, in Part III, F&E briefly sketch out how "the kind of variable and flexible federalism" (p. 86) that they propose may help to solve problems not only in the EU but "Beyond Europe" (chpt. 8) and how, in particular, developing countries may benefit from adopting this institutional device (chpt. 9).

## 2. FOCJ and Traditional Federalism

The innovative elements of F&E's FOCJ concept can be appreciated best if one starts from a brief description of the traditional structure of federal polities:

- In such systems political authority is divided between several levels of multi-purpose governments.<sup>5</sup>
- At each level, except for the most inclusive unit, several jurisdictions exist among which the territory included in the next-higher jurisdiction is divided.
- The political domains of jurisdictions at the same level are, in such manner, territorially demarcated.
- The political domains of jurisdictions at different levels are functionally demarcated, i.e. their authority applies to the same territory but pertains to different kinds of public services.
- Within its respective territorial domain each jurisdiction is a monopoly supplier of the public services that are included in its range of authority.
- Each individual citizen is a member of one jurisdiction at every level, (normally) due to his residence in the territory over which these jurisdictions extend.
- Individual citizens can express their satisfaction or dissatisfaction with the performance of governments at the various levels by using their voice-option in the respective political processes.
- Individually and separately citizens can respond to unsatisfactory performance of governments only by moving out of the respective territory and into some other jurisdiction.

In the traditional system of federalism the two instruments by which citizens can respond to the performance of their (communal-, state-, national or supra-national) governments, namely exit and voice, are limited in their effectiveness, in particular because of two reasons. First, jurisdictions in the traditional system are multi-purpose and, second, they are territorially defined.

That jurisdictions are multi-purpose means that citizens can use their voice- or their exit-options only as an overall response to their satisfaction with the aggregate bundle of public services that is offered in a jurisdiction. Such overall response can, however, only reflect their net evaluation of the entire bundle. By their vote citizens can only sanction governments for their aggregate performance, or choose among the service-bundles promised

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<sup>5</sup> As F&E note, "there are (normally) three levels of multi-purpose governments: the central state, the regions (states, Länder, cantons) and the communes" (p. 32).

by alternative candidates.<sup>6</sup> And by moving from one jurisdiction to another, individuals can only respond to their overall evaluation of the respective packages offered in alternative jurisdictions. Even if on balance the bundle offered in one's home-jurisdiction may be preferred over the bundle offered in alternative jurisdictions, it may well include services that, on the basis of an item by item evaluation, a citizen may find unsatisfactory, compared to what is offered in other jurisdictions. As a consequence, the competition for votes as well as the competition for residents-taxpayers are bound to be less effective in disciplining governments than would be the case if the packages of public services would be *unbundled* and citizens could separately discipline governments for their performance in each and every service-dimension. Governments that provide complex service-packages can afford to be less responsive to the preferences of their constituencies than they would otherwise have to be, and the more so the more complex these packages are. Surely, the suppliers of ordinary goods and services in markets would likewise be less constrained in their performance if consumers could not choose item by item from whom to buy, but would be limited to select among suppliers who only offer them a choice of pre-packaged bundles of various goods and services.

Second, since in traditional territorial federalism governments are monopoly-providers of their respective bundles of public services within their territory, citizens can individually and separately choose among alternative service-providers only by moving from one geographically defined jurisdiction into an other. To be sure, as F&E point out, an important advantage of traditional federal systems, compared to unitary states, is that "the mechanisms of entry and exit ... create competition between the various suppliers of public services, and induce them to act efficiently" (p. 16). Yet, to the extent that geographic mobility is costly, governments can afford to be less responsive to the interests of their constituencies, than they would have to be if a choice among alternative suppliers were possible without the need to relocate. Local monopolists in ordinary markets enjoy a similar advantage, except that they are disciplined by the competition from potential entrants, something that governments, because of their legal monopoly privileges, have not to fear.

It is with regard to the two noted drawbacks that limit the effectiveness of traditional federalism that F&E's FOCJ device is meant to provide a remedy. It is designed to impose stronger incentives "on politicians and governments to fulfil citizens' preferences ... by strengthening the *political* competition at all levels of government" (p. 3). The way to do this,

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<sup>6</sup> By other forms of "voice," other than voting, citizens may seek to influence particular aspects of government behavior, e.g. by voicing protest against specific government measures or by lobbying in favor of certain

F&E argue, is to open "the market for government services ... for competitive public jurisdictions focussing on the production of particular services" (ibid.). By allowing for functionally specialized jurisdictions, F&E argue, the package of services offered by "traditional all-purpose jurisdictions" (p. 11) can be unbundled, enabling citizens to use their voice and exit options in a more targeted and effective way. The essence of their proposal is that more flexibility is introduced in the "market for public services" on the supply side as well as on the demand side. On the supply side, instead of having monopoly suppliers of public services in pre-defined territories, competing suppliers are to be allowed to offer their services. On the demand side, instead of having to move from one territorially defined jurisdiction into another if they wish to switch to a different supplier, citizens are to be allowed to choose among alternative suppliers without the need to relocate.

### **3. FOCJ and the "Geography of Problems"**

The "opening of the market for government services" that F&E have in mind is to be achieved by allowing for what they call a "*fifth freedom*," in reference to the four freedoms that citizens enjoy in the European Union (free mobility of goods, services, labor and capital). As they argue, a political unit that wants to take advantage of the FOCJ device "must provide the lowest political units (the communes), and possibly also individual citizens, with a guarantee of participation in FOCJ" (p.4). Even though F&E use primarily the EU as an example and have given their book the title "The new Democratic Federalism for Europe," they make clear that their FOCJ concept is meant to be much more widely applicable, and that one of its specific advantages is that it can be implemented in a piecemeal fashion, "piecemeal" in terms of the geographical area to which it is applied as well as in terms of the functions included. Geographically, it can be implemented in any jurisdiction above the level of communes, from regions to nation states and beyond, to multi-national arrangements of any size. Functionally, the FOCJ device can be, but need not be, implemented as a full-fledged competitor with regard to all functions that are now performed by existing jurisdictions. It may be introduced only for a restricted set of functions with the option gradually to extend its range of operation.

Spelled out in more detail, what F&E suggest under the rubric of a "fifth freedom" appears to be the following. Starting from the institutional status quo where communes are the smallest (territorially defined) political units there should be a change in the rules of the game such that:

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programs. The capacity to discipline governments with regard to particular service items is clearly an important

- Communes (as first-level jurisdictions) are free to form functional (second-level) jurisdictions with other communes for the purpose of providing specific public services.<sup>7</sup>
- Communes are free to exit from and to enter into existing functional jurisdictions.
- Citizens are free to form new functional jurisdictions, independent of the existing territorial structure of traditional communes.
- Citizens are free individually and separately to join and to exit from existing functional jurisdictions.

The use that citizens will make of the above rights - either collectively through, communal decisions to form, join or exit from functional jurisdictions, or individually, through their individual and separate choices to join and exit from such jurisdictions – will set in motion, as F&E suggest, an evolutionary process of discovery and learning in which, by trial and error, a web of overlapping functional jurisdictions will emerge, each of which specializes in those services for which it enjoys a comparative advantage. In this competitive discovery process the traditional, territorially defined jurisdictions, from communes to nation states, will ultimately be left with those functions which they are able to perform more efficiently (p. 9).

A principal advantage that F&E attribute to a functioning system of FOCJ is that "the geographic extension of a FOCUS" can be adjusted to the "physical extension of a problem" (p. 3). The traditional structure "where historically given governmental units have a monopoly of supply of a large variety of public services" (p. 40) must inevitably be less adapted to the multifold overlap of problem-spaces that exist in reality, with the result of "large spill-ins and spill-outs" (ibid.). By contrast, "FOCJ are an institutional way to vary the size of public jurisdictions in order to minimize spillovers" (p. 41). They allow the complex structure of problem-spaces to be accommodated by a symmetrically structured pattern of overlapping functional jurisdictions. As F&E put it: "FOCJ form an adaptable network of governmental units that depend closely on citizens' preferences and adjust to the 'geography' of problems" (p. 4).

The institutional proposal that F&E submit as a means to introduce more competition into politics will, not doubt, appeal to anybody who shares their normative premise that the appropriate measuring rod for the quality of political institutions is their capacity to induce suppliers of public services to be responsive to the interests of their constituents. Their concept of FOCJ provides important suggestions for how we might come closer to a constitution of politics that allows the *invisible hand* of competition to work as effectively in politics in support of citizen sovereignty as it works in markets in support of consumer

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advantage of the methods of direct democracy that F&E advocate.

<sup>7</sup> The examples that F&E specifically mention are fresh water provision, refuse or waste water collection, old age pension and, in particular, school education.

sovereignty. With their emphasis on the role of a functional federalism they have, undoubtedly, identified the essential dimension along which promising institutional reform will have to be sought.

To be sure, the condensed exposition of the "new federalism" that is presented in a book of 111 pages cannot possibly cover all the details of the intended institutional arrangement. Quite naturally, many aspects of the proposed scheme will need to be worked out more specifically, and many issues that the authors only briefly touch upon will have to be further explored in future research. In what follows I want to draw attention to a few issues that seem to me to be most in need of further clarification. They all have to do with one central question, namely that of the relation between *individual rights* and *communal rights* in the F&E's FOCJ concept.

#### **4. FOCJ: Communal or Individual Membership?**

When, early on in their book, F&E note that a functioning FOCJ system requires that the "guarantee of participation" be provided to "the lowest political units (the communes) and possibly also individual citizens" (p. 4), the passing manner in which they mention this aspect could make it appear as if this issue is not of great significance for their overall argument. And, in fact, they do not discuss in any detail the question of what difference it may make to the functioning of their FOCJ system whether the "guarantee of participation" is specified in one way or the other, even though they acknowledge, if only in passing remarks, that there is a significant difference between an arrangement in which citizens have the option individually and separately to choose among competing suppliers of public services and one in which they can exercise such choice only collectively as communes. As they note:

"The membership of a FOCUS<sup>8</sup> can be defined in two different ways. In the first case the smallest political units, normally the communes, may be the members. In that case an inhabitant of a commune automatically becomes a citizen of those FOCJ to which his or her commune belongs. Exit is possible only by leaving the commune. In the second case an individual citizen can decide freely whether he or she wants to be a member of a particular FOCUS" (p. 7).

To be sure, in either case, with individual as well as with communal membership, F&E's functional federalism would have the advantage of unbundling the service-packages of traditional multi-purpose jurisdictions, with the promise of allowing for more flexibility in the provision of public services.<sup>9</sup> Yet, it should be obvious that the two versions of their scheme,

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<sup>8</sup> F&E use the term "FOCUS" as the singular form of "FOCJ."

<sup>9</sup> In this sense, F&E can certainly justly claim that "it is efficient when not all services are provided by the same governmental unit but are instead supplied by specialized functional jurisdictions" (p. 5).

F&E speak of "*collective FOCJ*" and "*individual FOCJ*" (p. 28), may well exhibit different working properties, with potentially significant implications for their effectiveness in inducing governments to be responsive to citizens' preferences.

When F&E note that "FOCJ compete for communes and citizens" (p. 4), that they "need not have a monopoly of supply for a particular function" (p. 5), and that "exit from FOCJ does not necessarily require geographic mobility" (p. 6),<sup>10</sup> it is important to recognize that "competition," "monopoly," and "exit" mean quite different things for communal as opposed to individual FOCJ arrangements. In case of the latter it is individual citizens that FOCJ have to compete for. Citizens can choose as individuals among competing jurisdictions, none of which has a monopoly in the commune in which they live. And they can exit from unsatisfactory service providers to more attractive competitors without change in residence. By contrast, in case of collective FOCJ, communes are the relevant choosing entities. They have a choice among alternative FOCJ and, in this sense, are not dealing with a monopolist. Yet, by its very nature such communal choice is about deciding who is to be the (temporary) monopoly provider for the commune. That is, from the citizens' perspective communal choice among FOCJ does not change the fact at all that to them, as individuals, the FOCJ chosen by their commune are monopolists. And even though communes may switch their membership "without moving physically" (p. 6), for individual citizens this is not true at all.

To be sure, compared to traditional territorial federalism, the added communal choice options can be predicted to make FOCJ-arrangements more responsive to citizens' preferences. Yet, there can also be no doubt that, in this regard, the two kinds of FOCJ are bound to be different. Since "individual FOCJ" allow residents of the same commune to belong to different jurisdictions such that individual citizens can choose among competing public service suppliers without moving, they clearly offer citizens better protection against unsatisfactory service than "collective FOCJ" and they should, therefore, appear to be the preferable alternative - wherever a choice is feasible.

A "collective" FOCJ system remains, from the individual's perspective, no less a territorial scheme than traditional federalism. It is by virtue of their residence in a particular commune that individual citizens belong to the set of overlapping functional jurisdictions that "their" commune has chosen to join. Even if they have a voice in their commune's choice among alternative functional arrangements, individually and separately they can choose among alternative suppliers of public services only by moving to some other territorially

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<sup>10</sup> "Exit from FOCJ does not necessarily require geographic mobility; citizens or communes may switch membership without moving physically. The threat of exit is, therefore, particularly effective" (p. 6).

defined commune, thereby obtaining membership in the set of functional jurisdictions that is associated with that commune.

Much of what F&E say about the advantages of a FOCJ over traditional federalism sounds as if they are primarily thinking of arrangements with individual membership. In discussing the difference between their own proposal and Tiebout's model of spatial competition they note, for instance:

"In contrast to the 'voting by foot' model, the governments of FOCJ do not have a monopoly of supply over a particular geographical area but various public suppliers may compete against each other in the same area. As a consequence the citizens do not have to move geographically when they switch from one public supplier to another. While the assumption of costless mobility for the citizens is obviously unrealistic in Tiebout's model, it is much more appropriate for FOCJ" (p. 37).

Obviously, the "assumption of costless mobility for the citizens" is not equally appropriate for all kinds of FOCJ. It is realistic for arrangements with *individual* membership, but much less so for those with communal membership. Since, however, individual membership is clearly not a feasible option for all services that governments provide, the question arises of how the dividing line is to be drawn between public services that may or may not be provided by "individual FOCJ," and how the "new federalism" that F&E have in mind is to deal with the issue of deciding how rights and responsibilities are to be divided between "individual FOCJ" and "collective FOCJ."

Commenting on whether "individual or communal membership may be the more appropriate solution" (p. 7) F&E note that this depends "on the function" (*ibid.*).<sup>11</sup> As they recognize, the option for dissatisfied persons to "join another FOCUS without having to change their location" (p. 18) is limited to cases where "production conditions allow multiple suppliers to coexist" (*ibid.*). And this is obviously not the case for all public services. "The crucial factor," they argue, "is the extent of 'publicness' of the goods and services in question, that is, the extent to which *externalities* affect other individuals and groups" (p. 29).

If "publicness" means that the benefits of a service, once it is provided, can be enjoyed by anybody who resides within the territorial area that is covered by the service, it is indeed difficult to imagine a workable system of "individual FOCJ" that would allow residents in the same area individually and separately to choose among competing suppliers. Such a system with individual membership can work only for services that permit suppliers to treat residents *within the same area* differently, restricting their services to paying members and withholding them from non-paying residents. This is not possible, however, for *local public goods*, and to

the extent that F&E think of FOCJ as providers of such goods<sup>12</sup> we would have to conclude, it seems, that a FOCJ-system cannot be anything other than a communal system, and that no real choice between individual membership and communal membership exists. Where local public goods are concerned, it is only by making all potential beneficiaries within the relevant area paying "members" that non-payers can be excluded from consuming the service. In other words, membership in the FOCUS providing the respective service must be based on residential criteria and cannot be a matter of individual choice, independent of residence.

If by "public services" we were to mean only services that are "public" in the above sense, individual membership would not be a real option. It is only if the term is understood in the more neutral sense of "services provided by governments" that we can meaningfully speak of individual and collective FOCJ as potential alternatives. This brings us back, however, to the question of how in F&E's new federalism the division of labor between the two is to be conceived.

### **5. The "Fifth Freedom": Individual or Communal Rights?**

The division of labor between individual and collective FOCJ obviously depends on what is meant by the "guarantee of participation" (p. 4) of which F&E speak. It depends on what is exactly implied when they say: "The formation and functioning of FOCJ must be constitutionally guaranteed. It should be possible for the units to incorporate themselves as jurisdictions with (limited) power of enforcement" (p. 74). As they speak of a "fifth freedom" (p. 4), one might be led to infer that they are thinking of rights of individual citizens. After all, the other "four economic freedoms" in the EU are about such individual rights. Yet, what has been said above suggests that this cannot quite be what they have in mind.

In fact, there is a certain ambiguity involved when F&E say about their FOCJ concept "that citizens must have the right" (p. 4) to form, join or exit from functional jurisdictions. It can mean two very different things. It can mean that citizens can exercise that right *as individuals*, or it can mean that they hold this right only jointly, *in their collective capacity* as members of communes.<sup>13</sup> The latter interpretation is implied when F&E say: "The citizens must have the right to decide for themselves whether their commune should join a particular FOCUS" (p. 4), or when they note: "In a system of FOCJ, each commune would choose

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<sup>11</sup> "Whether communes or individuals form FOCJ depends on the specific circumstances" (p. 28). "Who the members are depends on the functions concerned" (p.75).

<sup>12</sup> "The concept of FOCJ relies on the idea that many, of not most, public goods are local" (p. 42).

<sup>13</sup> Similarly, it can mean quite different things when F&E say that a "citizen is ... a member of several jurisdictions" (p. 5). It can mean that as individuals they belong to several FOCJ, or it can mean that as citizens of a commune they are indirectly members of the FOCJ to which their commune belongs.

according to which functions it wants to team up with other communes" (p. 86).<sup>14</sup> By contrast, the former seems to be implied when F&E say that citizens "must have the right to leave the jurisdictions they belong to either totally or with respect to particular functions" (p. 5).<sup>15</sup>

One might argue, perhaps, that no ambiguity needs to be implied here since the "fifth freedom" may well be granted to citizens individually as well as to citizens in their collective capacity, as constituents of communes. Indeed, F&E seem to have this in mind when they say: "Both individuals and communes (as the lowest political unit) should have the possibility of establishing FOCJ" (p. 75).<sup>16</sup> Yet, the problem with such interpretation is that the two versions of the "fifth freedom" cannot simply be presumed to be generally compatible with each other. It is not too difficult to imagine how a FOCJ system based on communal membership might be implemented by a constitutional provision, adopted by a more inclusive political unit, that guarantees communes (or other lower-level units) the right to freely associate with, or dissociate from, other communes in order to form functional jurisdictions that are specialized in the provision of particular services. Whatever practical problems may arise once such a system would actually be set in motion, conceptually it appears to be a workable arrangement. What is, however, much more difficult to imagine is how a FOCJ system with individual membership is to be implemented, and how the "fifth freedom" may be guaranteed to citizens as individuals in ways that are compatible with the presence of communal FOCJ. Must not potential conflict between individual and communal rights be expected to arise, as the manner in which citizens may wish to exercise their individual rights to "participate in FOCJ" may get into conflict with the manner in which the constituencies of their communes decide to exercise the respective communal rights? Where such conflicts arise not both can have their way. In order to be workable, a FOCJ system must be able to avoid such conflicts, or resolve them where they arise.

F&E expressly state that "the constitution should not fix in advance whether FOCJ are to be based on individual or communes but should allow both types to form" (p. 75), yet they appear to have an arrangement in mind that avoids the noted conflicts by giving priority to communal rights over individual rights. This is at least what they seem to imply when, on the issue of individual versus communal membership, they note: "As public jurisdictions serve to

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<sup>14</sup> That the "fifth freedom" is about rights of communes is also implied when F&E note that presently in Europe the formation of FOCJ is impossible "because the respective communes have insufficient competencies to make such a step" (p. 72).

<sup>15</sup> That F&E are thinking here of individuals' right to choose can be inferred from the fact that the quoted remark is followed by the statement: "When they decide to exit they must receive a tax rebate corresponding to the cost of the services they no longer consume" (p. 5).

supply particular services – either public goods or goods with marked external effects – the natural starting point is for communes to constitute the FOCJ members. These *collective FOCJ* may then decide whether they wish to allow individuals to establish their own FOCJ" (p. 28).<sup>17</sup>

If it is up to collective FOCJ or communes to decide whether jurisdictions with individual membership are to be allowed then, obviously, the "fifth freedom" is directly guaranteed to communes only, not to individual citizens. Individuals are granted that freedom only indirectly, to the extent the communes to which they belong decide to allow for it. There are no constitutional guarantees, one must conclude, that would give individuals a claim to such freedom where their communes decide otherwise.

## 6. FOCJ as "Public Jurisdictions"

The need for F&E to be more specific about the role that, in their scheme of things, they see for functional jurisdictions with individual membership is also apparent when they insist that FOCJ are "public jurisdictions." Contrasting their own FOCJ concept with Buchanan's (1965) "theory of clubs" F&E note: "Clubs are private; their membership is based on a private contract while FOCJ are public jurisdictions with the constitutional power to impose taxes" (p. 39).<sup>18</sup> - As applicable as this description may be to collective FOCJ, with regard to individual FOCJ it surely needs to be qualified.

Whether FOCJ, individual and collective alike, can be generally said to be "jurisdictions with the power to raise taxes with which they finance the expenditures needed to fulfil their functions" (p. 4) depends, to be sure, on how we want to define "taxes." By a tax we typically mean a compulsory levy collected by a government from persons (natural or legal) within its territorially defined jurisdiction. Taxes in this sense are commonly contrasted to fees or charges that are collected, whether by governments or other agencies, from persons who choose to consume particular services provided by such agencies. Where FOCJ are to provide local public goods, F&E can rightly say: "Without any doubt the power to impose taxes is crucial in order to provide services" (pp. 74f.). As noted above, the "publicness" of such goods implies that, within the area covered by the respective service, nobody can be

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<sup>16</sup> Symmetrical rights for individuals and communes seem likewise implied in F&E's remark: "FOCJ are discontinued when their services are no longer demanded as more citizens and communities exit and the tax base shrinks" (p. 18).

<sup>17</sup> A priority of communal rights is also suggested when F&E remark on the example of "old age pensions": "One possibility is for various communes to come together in order to ... establish a collective pension FOCUS. The people living in the member communes are automatically part of the pension system. ... Another option is that communities ... decide to leave this decision to the individual citizens" (p. 28).

excluded from consuming it, once it is provided. Therefore, free-riding can be prevented only by requiring all potential beneficiaries in the relevant area to be paying members. This is the reason why the provision of local public goods is the natural domain of collective FOCJ. And with regard to such arrangements we can, indeed, say: "Within a FOCUS the public good objective behind many public services requires citizens to agree collectively to pay taxes which finance these services" (p. 42).

All the above statements must be qualified, however, when we speak of functional jurisdictions with individual membership as opposed to communal arrangements. Individual FOCJ can discriminate between paying members and non-paying residents, and they can finance their services by making access to these services contingent on the willingness to pay the required membership fee. They do not need "the power to raise taxes." All they need is the right to exclude non-payers from consuming their services. In this regard they appear, in fact, not to be very different from Buchanan's clubs. Just as clubs are able to charge for the club-goods that they provide to their members, individual FOCJ that provide collective goods to their clientele can finance their services as long as they are able to attract enough members who value these services high enough to be willing to pay the required membership fee.

To the extent that their FOCJ concept is meant to include individual membership arrangements F&E seem not only to overstate the difference to Buchanan's club concept. They also seem to draw too sharp a line between their proposal and "the suggestion of privatizing public services" (p. 42).<sup>19</sup> When they emphasize that "the concept of FOCJ does not just amount to privatization" (p. 8) this is obviously true for collective FOCJ. Yet, with regard to individual FOCJ the differences between the arrangements that F&E have in mind and private arrangements may not be quite as obvious. To be sure, functional jurisdictions with individual membership may be said to differ from "privatization" if only communes were allowed to operate as service-providers. But why should access to the market be restricted to communal suppliers where services are concerned that can be provided on the basis of individual membership? Why should not non-communal suppliers, such as private firms, be allowed to offer their services to citizens, and why should not citizens be allowed to decide for themselves whether they prefer communal or private suppliers? If responsiveness to citizens' preferences is what we aim at, why should we want to exclude a priori potential private competition? If, however, such competition is allowed, what is the essential difference

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<sup>18</sup> "A FOCUS is a formal political unit with powers to regulate and to tax" (p. 7). "FOCJ are ... government units with the power to impose taxes" (p. 42).

<sup>19</sup> After saying that FOCJ are "governmental units with the power to impose taxes" F&E add: "This feature distinguishes FOCJ from a purely private provision of public services" (p. 42).

between the FOCJ concept in its "individual" part and suggestions for "privatizing public services"?<sup>20</sup>

It is, of course, not without reason that F&E face apparent difficulties in clearly demarcating the respective roles of individual and collective FOCJ in their proposed scheme. These difficulties have to do, in particular, with the fact that many of the services that governments traditionally provide comprise a mixture of components, including elements with obvious public good characteristics as well as elements that might well be accommodated by individual membership arrangements.<sup>21</sup> The issues that result from this mixture are reflected, for instance, in F&E's comments on school education, the example of a public service that they say most about in their book (pp. 17, 26, 33, 74).

On the one hand they mention the "school example" (p. 18) as an instance where "production conditions allow multiple suppliers to coexist" (ibid.) and where, therefore, FOCJ may be formed on the basis of individual membership, by contrast to "other cases, say the provision of fresh water" (ibid.), where "multiple supply is likely to be more difficult" (ibid.).<sup>22</sup> On the other hand they recognize that individual membership may allow for free-riding on certain public good aspects of an educational system. This leads them to conclude:

"Citizens can be given the option of choosing which school-FOCUS to enter but in order to ensure that people without children contribute to school taxes, every citizen must be a member of some school-FOCUS. In order to prevent the founding of school-FOCJ without services and taxes (designed for citizens without children), minimum service levels can be prescribed" (p. 7).

The notion that citizens without children should be required to make a certain minimum contribution to the provision of school education is obviously founded on the assumption that a functioning school system generates benefits to the population at large, not only to those who, as parents, directly consume its services. The idea, on the other hand, that the immediate "customers," i.e. citizens with children, should have the option to choose among alternative suppliers is clearly based on the assumption that school-education is a public service with only limited "publicness," and with major components that can be provided for by individual FOCJ.

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<sup>20</sup> That the dividing line between individual FOCJ and private arrangements for the provision of public services may not be that sharp is indirectly suggested when F&E state: "Such *individual FOCJ* may take many different forms. On one extreme we have FOCJ comprising many individuals who provide collective goods and services for its members; on the other extreme there are 'FOCJ' composed of only one person in which case we have the normal private good provision without any collective element" (p. 28).

<sup>21</sup> These difficulties are aggravated by the fact that, with changing technologies, the borderline between the two categories changes over time.

<sup>22</sup> "Thus it can well be conceived that individual citizens would form a FOCUS for a particular public school. In other policy areas, such as collection of waste water, communes would most likely come together to establish a FOCUS" (p. 75).

The question is how the noted mixture of components in public services can be accounted for by a FOCJ system. As a solution F&E suggest, on the one hand, to allow for the formation of individual FOCJ that would be financed by membership fees, but, on the other hand, to have such arrangements be constrained by regulations and have them supplemented by compulsory taxation, in order to take care of the public goods aspects.<sup>23</sup> It seems to me that their suggested solution can be further developed towards a systematic strategy that aims at separating the genuine public good components from those that allow for "multiple suppliers," assigning the former to collective FOCJ, the latter to individual FOCJ. In case of F&E's education example, the genuinely public components would be the subject of collective FOCJ that decide on regulation and education-taxes on the basis of communal membership, while the service-components without or only insignificant "publicness" would be assigned to individual FOCJ. Citizens without children would be taxed as members of the respective collective FOCUS but would not need to belong to any of the individual school-FOCJ. Such a system, one may add, would seem not to be too different from proposals to partially "privatize" school education on the basis of a voucher system, proposals that have long been discussed by economists.

The above argument applies to all instances of public services with varying degrees of "publicness," to the extent that their "public" components can be meaningfully separated from those that allow for individual membership arrangements.<sup>24</sup> Where such separation is possible, the respective assignment of public and non-public components to collective and individual FOCJ is, indeed, suggested by the very logic of the concept of a functional federalism that is at the heart of F&E's proposal. The advantages of functional specialization clearly do not end at the level of conventionally defined public services as indivisible entities. Wherever conventionally defined public services, like, for instance, "public education," are decomposable in the above sense, the assignment of their non-public elements to individual FOCJ can surely help to make service-providers more responsive to citizens' preferences.

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<sup>23</sup> Such regulation may, for instance, mandate for particular services that all citizens must join a FOCUS but can choose among competing individual FOCJ. This is what F&E appear to have in mind when they say that "the public good motive also requires that a citizen has to be forced to belong to *some* FOCUS" (p. 42).

<sup>24</sup> F&E seem to have some such separation in mind when, in the context of discussing the issue of "redistribution," they note: "A strong form of individual choice opportunities may undermine public redistribution schemes. If desired, redistribution and a minimum level of public services can be guaranteed by a higher political unit. Membership in a FOCUS offering the public service in question can be made obligatory, and the quantity may be prescribed" (p. 7).

## 7. FOCJ and Direct Democracy

There is one more aspect of F&E's proposal for a new federalism that needs to be qualified in light of the systematic differences between individual and communal FOCJ arrangements. This concerns their views on the role of democratic participation.

As noted at the beginning, F&E take particular care to point out that their FOCJ concept is not just about recommending a shift from traditional territorial federalism to functional federalism. It is also concerned with "strengthening the direct participation of citizens" (p. 80). In fact, they insist that it is the role of democratic participation, and in particular of direct democracy, that distinguishes their proposal from other perspectives on competitive federalism, such as Tiebout's theory of spatial competition<sup>25</sup> or Buchanan's club-theory.<sup>26</sup> It is, as they suggest, the very combination of "easy exit and entry opportunities and well-established democratic participation rights" (p. 18) that assures that in a FOCJ system governments have to be particularly responsive to citizens' preferences, and are induced to provide public services efficiently.<sup>27</sup> Specifically they argue: "The governments of FOCJ are subject to two mechanisms forcing them to cater to the preferences of their members: The option for citizens and communes to exit FOCJ establishes competition similar to markets, and in addition their voting rights establish political competition" (p. 6).<sup>28</sup>

The question that, in my view, must be raised is whether one can indeed suppose, as F&E do, that FOCJ generally combine the advantages of easy exit and of strong political control. By speaking of the "option for citizens and communes to exit" and by stating that "FOCJ compete for communes and citizens" F&E seem to me to gloss over essential differences that exist between individual exit versus communal exit and between competition for individual citizens versus competition for communes, differences that have significant implications for the role that political participation can play within the two kinds of FOCJ arrangements.

In case of collective FOCJ, individual citizens are, as F&E recognize, automatically members of whatever functional jurisdictions the commune in which they live chooses to join. No individual exit is possible, except by moving out of the communal territories covered by

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<sup>25</sup> In reference to Tiebout F&E note: "Political competition via elections and referenda, which in FOCJ plays a crucial role, is implicitly considered to be superfluous" (p. 37).

<sup>26</sup> "In contrast to Buchanan's clubs, FOCJ attribute a large role to the formal political participation rights of citizens" (p. 39).

<sup>27</sup> "The functional orientation of FOCJ, as well as the strong political competition induced by exit and entry and by direct democratic rights, produces a differentiated policy caring for the citizens' demands" (p. 17). "Strengthening the democratic and exit options help the citizens to express their demands and to effectively control the government" (pp. 7f.).

these jurisdictions. The fact that their commune can exit from a FOCUS means for individual citizens that, by exercising their voice-option in the communal decision making process, they can express their preference for joining a particular FOCUS rather than some other. Yet, whatever their own preference is, they will have to live with whatever outcome the communal choice process generates. Nevertheless, because of the limited force of the individual exit option - and the more so the higher the costs of exercising that option -, participation rights in the political process are the principal instrument for citizens to discipline governments. This is the reason why political participation is essential in collective FOCJ. As far as the latter are concerned, F&E are surely right in suggesting that instruments of direct democracy can help to make for more responsive government. And they may also be right in arguing that in a functionally specialized jurisdictions direct democracy is both more important<sup>29</sup> and more effective<sup>30</sup> than in traditional multi-purpose jurisdictions.

The situation is, however, quite different in the case of individual FOCJ. Under individual membership arrangements individuals can choose, without the need to change their residence and, therefore, at low exit costs, among competing public service providers. They can easily escape poor performance, simply by shifting their alliance to a more attractive competitor. Since easy exit provides effective protection against unsatisfactory service, it is not at all obvious, and the less so the lower exit costs are, why, as F&E suppose, "it is to be expected that the members of FOCJ will choose to have as much direct participation as possible" (p. 24).<sup>31</sup> If it had, indeed, to be "taken for granted that the threat of exit is not sufficient to force the governments of FOCJ to fully meet the citizens' preferences" (p. 38),<sup>32</sup> then citizens would obviously have good reasons to make sure that their participation rights, as members of FOCJ, allow them effectively to control "the managers or politicians in the daily running of FOCJ" (p. 24). But it is doubtful whether this is a reasonable assumption for individual FOCJ. Why should citizens care to invest effort in exercising their voice option if they can easily switch to a more attractive FOCUS when they are not satisfied with their present service-provider? Why should we expect individual FOCJ to provide inferior service

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<sup>28</sup> "FOCJ compete for communes and citizens, and they are subject to democratic political competition. Popular referenda, and possibly citizens' meetings, may be used for that purpose in addition to the normal representative political institutions" (p. 4).

<sup>29</sup> According to F&E, "direct democracy ... is more important in FOCJ than under the already existing governmental institutions" (p. 35).

<sup>30</sup> "The concentration of a FOCUS on one or at most a few public services makes it easier for the citizens to evaluate efficiency and to compare it to other FOCJ" (p. 8). "FOCJ perform well-defined tasks, and the institution of direct democracy, therefore, promotes a focused discussion" (p. 26).

<sup>31</sup> As F&E add, this is so "because (besides exit and entry) it [direct participation, V.V.] constitutes an effective means of controlling the managers or politicians in the daily running of FOCJ" (p. 24).

if they are effectively constrained by the necessity to please members who have easy access to potential alternatives? And why should we expect them to become more efficient service providers if, besides the exit constraint, they are under the additional constraint of strong participation rights?<sup>33</sup>

The conjecture would seem to be plausible that the need for citizens to rely on democratic participation rights, as well as their interest in exercising such rights, are negatively correlated with the ease of exit. The more costly it is for them individually to exit from a functional jurisdiction, the more they will need the protection that democratic participation can offer. Conversely, the easier it is for them to transfer their membership between competing providers of public services, the less likely it is that they will feel the need to exercise their voice option. Accordingly, we should expect citizens to have different opinions about these matters when they deal with individual rather than collective FOCJ, a fact that F&E implicitly recognize when, in explaining the alleged insufficient force of exit, they argue: "As a result of decisions and transaction costs, citizens may be unwilling to leave the FOCUS they presently belong to. Though it suffices that exit is undertaken by a few 'marginal' citizens, the barriers to switching may still be so large that governments of FOCJ enjoy considerable power. This may especially happen when members of FOCJ are composed of communes rather than individuals" (p. 38).

Whatever one may conjecture, however, about citizens' interests in political participation, there is an obvious way to test this issue following the very logic of the concept of a functional federalism. Why should one make it a general requirement that all FOCJ, including those based on individual membership, be organized as democratic entities with particular institutional features such as direct democratic elements? Why should citizens not be allowed, where individual FOCJ are concerned, to choose among suppliers with different organizational characteristics, and to find out for themselves what kind of organizational structure serves their needs best. As long as citizens can easily switch between competing jurisdictions, one should expect FOCJ to be successful, i.e. to be able to attract members, in proportion to their ability to offer attractive price-service packages to citizens. If jurisdictions with strong elements of direct democratic participation should, indeed, be better able to meet citizens' preferences than FOCJ that rely more on indirect representation, or if democratic

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<sup>32</sup> As F&E argue: "Under realistic conditions, exit is not sufficient to secure efficiency. As long as individuals have no political rights the governments have considerable discretionary power to deviate from the preferences of the citizens. Thus FOCJ guarantee political competition by their democratic institutions" (pp. 6f.).

<sup>33</sup> In fact, might one not suspect that strong participation rights may interfere with the capacity of an individual FOCUS to attract members, if one considers the potential asymmetry between the kinds of persons who are likely to make use of their participation rights and those who are likely to rely on their exit option?

FOCJ should be more efficient public service providers than "private" FOCJ that do not provide their members-customers with participation rights, such superiority should be reflected in their ability to attract more members than their less democratic competitors. The advantage of having this issue decided by a process of competition rather than by ex ante decree is that we can benefit from the discovery potential of an explorative process that can help us to find out, by trial and error, what we cannot reasonably claim to know a priori, namely which kind of organizational form is best suited to serve citizens' public service needs.

### **Conclusion**

The central claim of F&E's book is that their FOCJ concept promises to make for a new, more responsive federalism. If the suggested institutional reforms are, in fact, to induce more responsiveness to citizens' preferences, they must do so by strengthening the role that citizens play as controlling agents or as ultimate sovereigns, i.e. as those who hand out the relevant positive and negative sanctions to the suppliers of public services.<sup>34</sup>

How this might be achieved is easy to see in those cases where citizens are free to choose, as individuals, among competing public service providers without the need to move physically from one jurisdiction into an other. This has been, indeed, the focus of earlier contributions to the notion of a functional federalism.<sup>35</sup> The principal argument in the earlier discussion has been that, since under territorial federalism the force of the exit option is limited by the costs of geographic mobility, exit could be made a much more powerful instrument for the protection of citizens' interests, if all those public services that do not require territorial monopolies were separated out from the service-packages traditionally provided by territorial governments, and were provided for on a functional basis, allowing competing suppliers to operate in the same area. In this context the primary interest was in identifying those parts of traditional government activities that may be suitable candidates for a functional federalism.

With their FOCJ concept F&E go beyond the earlier debate by generalizing the notion of a functional federalism in a way that includes arrangements with communal membership. This is an important innovation, but also one that raises a number of new issues. While with F&E's communal FOCJ certainly additional flexibility is introduced in the "market" for public services, it is obvious that, as far as their responsiveness to citizens' preferences is concerned,

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<sup>34</sup> What is required is that – in F&E's words – "the citizens dominate the formation process of the FOCJ" (p. 4).

<sup>35</sup> On this see Straubhaar (1995).

we cannot simply ascribe to such communal arrangements all the virtues that we have come to associate with "genuine" functional federalism, i.e. with F&E's individual FOCJ.

F&E's inclusive system of individual and collective FOCJ surely has the promise of strengthening citizen sovereignty, but there is, as noted above, a lot more we need to know about its specific institutional features. Its actual working properties will critically depend on the "rules of the game" under which it operates, in particular the rules that decide on the role that will be allowed for individual FOCJ. F&E do, indeed, explicitly recognize the importance of the regulatory framework within which FOCJ are to operate,<sup>36</sup> and they even suggest that a "competition authority" (p. 75) be instituted to guarantee that exit and entry is regulated in ways that assure effective competition.<sup>37</sup> Yet, here again their approach is in need of further explication. It is surely not enough to say that "the decisions on whether FOCJ are composed of communes or individuals, whether membership is obligatory or optional, and how FOCJ are regulated, have to be taken in the *political process*" (p. 29).

What "the political process" will generate depends very much on its specific institutional characteristics. This is the very reason why F&E propose their FOCJ concept in the first place. It is meant as a suggestion for how the rules of the "game of politics" ought to be reformed in order to advance citizen sovereignty. If it is to serve that purpose, the FOCJ system must itself be framed by suitable constitutional rules. In the previous sections I have sought to point out some of the problems that such rules would have to address. Since the book that has been reviewed here is a report on an ongoing research effort, one may hope that the authors will let us know more about their ideas on these issues in publications to come.

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<sup>36</sup> They note that FOCJ are bound "by the regulations existing somewhere else in the *nation* or in the *EU*" (p. 32). "The fifth freedom ... will be more effective when the various jurisdictions are forced by constitutional decree to indicate their 'tax price menu'" (p. 9).

<sup>37</sup> "The 'competition agency' must fix general rules that determine the maximum prices for entry into, and exit from, a FOCUS" (p. 74). "The competition authority should enforce that the appropriate tax reduction for individuals and communes is granted" (p. 75).

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