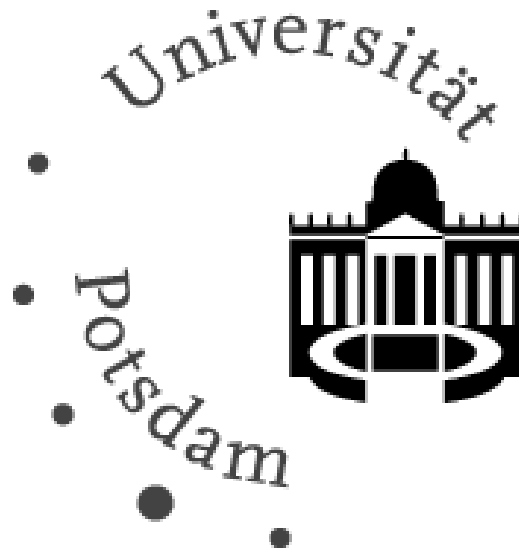


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Paul J.J. Welfens

## **Constitutional Issues and the Quality of Political Competition: Analysis and Implications for a Future EU Constitution**

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## Résumé

Ce document aborde des problèmes constitutionnels fondamentaux auxquels sont confrontés les pays de l'OCDE, ainsi que d'autres thèmes propres à l'Union Européenne. Tout en abordant des questions traditionnelles d'ordre constitutionnel, nous nous pencherons dans un premier temps sur certains problèmes en relation directe avec les nouvelles technologies de communication et le vieillissement des sociétés occidentales. Dans un deuxième temps, nous considérerons les options permettant d'améliorer la rationalité du processus politique. Parmi les innovations suggérées afin d'élaborer une future constitution européenne, nous proposons la répartition, entre l'Union Européenne et les pays membres, des coûts d'accès à Internet auxquels les écoles et les universités doivent faire face, de sorte à ce qu'une politique commune en matière de communication en cette période d'ère digitale puisse également être mise en place. De plus, l'Union Européenne devrait se préoccuper de définir un accès minimum à Internet permettant de répondre aux besoins des foyers des pays de la communauté, tout en incluant un nouveau concept universel de services digitaux. Le regroupement de hautes instances politiques et des médias dans l'un des pays de l'Union doit être un des principes à exclure de la future constitution européenne car ce système sape la division des pouvoirs au sein d'une démocratie. Par respect de la liberté individuelle, on ne devrait pas refuser le droit de travail aux retraités à condition que leur durée de travail hebdomadaire ne dépasse pas la moitié de celle en vigueur sur leur territoire national. La responsabilité des conventions collectives au sein de l'Union devrait être renforcée, et ce en supposant que les syndicats et le patronat soient amenés à se porter garants du plein emploi. Cependant, si le taux de chômage dans l'un des pays membres venait à dépasser durant deux années consécutives la barre des 10 %, le gouvernement de ce pays sera autorisé à intervenir dans la fixation des salaires, et ce, pour une période maximum de cinq ans. Tous les gouvernements nationaux doivent publier un minimum de statistiques concernant la différenciation régionale et verticale des salaires. En ce qui concerne les règles budgétaires, il faudrait pouvoir estimer les coûts à moyen terme générés par la mise en place d'une loi au niveau national et supra-national auxquels l'Etat et le secteur privé devront faire face. En période de sévère récession – il n'est pas question ici d'une récession ordinaire – il serait nécessaire, après décision à la majorité du Conseil des Ministres, de pouvoir coordonner les différentes politiques fiscales au sein de l'Union. Aussi, tous les pays membres pourraient de façon provisoire augmenter leur taux d'amortissement, mettre en place un système de primes afin d'encourager les investissements des entreprises (sur la base des investissements passés) ou soit baisser le taux d'imposition des foyers. Nous proposons ici deux taxes européennes bien distinctes l'une de l'autre : la première sur l'énergie, la deuxième sur le taux de chômage national. Finalement, nous proposons trois suggestions afin d'améliorer l'efficacité du processus politique : dans l'intérêt de la stabilité politique au sein de l'Union, le calendrier électoral de chaque pays devrait être fixé de telle sorte à ce que pas plus de la moitié des pays membres n'organise d'élections nationales au cours de la même année. En plus de cette innovation institutionnelle, il faudrait prendre en considération la proposition suivante, à savoir, rallonger la période de législature au Parlement Européen et de même pour les parlements nationaux : Quand la coalition gouvernementale est à nouveau élu, sa période de législature est rallongée d'un an. Aussi, plusieurs pays devraient pouvoir être représentés par un représentant commun au Conseil des Ministres et devraient y être encouragé. Quand par exemple plus de trois pays concluent un accord afin d'être représentés par un représentant commun, alors le poids de leur voix serait crédité de 10 % lorsqu'une décision à la majorité doit être prise. Ainsi, ce système contribue à ce que le nombre de personnes au sein du Conseil des Ministres reste limité, ce qui par la même occasion assure une prise de décision efficace. En annexe, vous trouverez le modèle présenté par Anthony Downs que nous avons modifié et développé pour finalement aboutir sur un système plus dynamique, dans lequel, un système politique reposant sur deux partis ne mène pas à deux programmes politiques identiques. Ainsi, on approche davantage de la réalité.

## Summary

This paper looks into basic constitutional issues faced by OECD countries – with special respect to EU issues. While traditional fields of constitutional rules are addressed, we also explore some specific problems related to modern communication technology and to the greying of western societies on the one hand and to the options for improving the rationality of the political process on the other. Among the innovations suggested for a future EU constitution are the sharing – Community/member states – of broadband internet access costs of schools and universities so that a Common Communication Policy in the digital age would become visible. Moreover, the EU should define a minimum broadband internet access requirement for households in all EU countries within a new concept of digital universal services. Bundling of top political power and media power in individual member countries must be ruled out within the constitution, because the division of power in democracies could otherwise be undermined. As a sign of respect for individual freedom, no retiree should be denied gainful employment for at least half the standard statutory working hours in the respective member country. Collective bargaining responsibilities in the EU should be strengthened under the assumption that trade unions and employer federations are mainly responsible for maintaining full employment; however, if the national unemployment rates exceed 10% for two consecutive years in a member country, the government will be allowed to intervene in the process of wage setting for a maximum of five years. All national governments must publish a minimum set of guidelines on regional and vertical wage differentiation. With respect to budgetary rules, future legislation at the supranational level and national level should provide medium-term cost estimates related both to the state and the private sector. Moreover, there should be cross-border coordinated fiscal policies in severe recessions – not in ordinary recessions; in a period of a severe recession, all member countries could envisage a parallel transitory increase in capital allowances or an investment subsidy (scaled relative to past investment) for companies; or a temporary tax reduction for households. We suggest two distinct EU taxes: One on energy, another on national unemployment rates. Finally, there are three suggestions for the political process: For the sake of EU political stability, national election calendars should be organized – under normal circumstances – in such a way that not more than half of the member countries should have a national election in the same year. In addition to this innovation one might consider an endogenous lengthening of the parliamentary period in the EU Parliament (and in national parliaments): The efficiency of the democratic process can be improved by introducing the rule that a majority combination of re-elected parties should benefit from an extension of the parliamentary period. As regards the Council of Ministers all countries should be encouraged to form groups of at least two countries so that they be jointly represented; if a group is comprised of three or more countries, the combined weight thus represented by one common representative is increased by 10% so that the number of people acting in the Council of Ministers will remain limited, helping to ensure smooth and efficient decision process. In the appendix, we modify the well-known Downs model and develop a dynamic model in which political competition will not bring about identical programmes in a two-party system; a change in government implies a change in policy – this is more consistent with reality than the traditional Downs model.

## **Zusammenfassung**

Dieser Beitrag befaßt sich mit grundlegenden konstitutionellen Fragen von OECD Ländern, wobei insbesondere auch EU-bezogene Themen behandelt werden. Einerseits werden traditionelle Verfassungsbereiche thematisiert, aber wir untersuchen auch spezifische Probleme, die im Zusammenhang mit modernen Kommunikationstechnologien und dem langfristigen Alterungsprozeß westlicher Gesellschaften stehen; zudem gehen wir auf prezudurale Optionen für den Politikprozeß unter dem Gesichtspunkt einer Erhöhung des Rationalitätsgrads der Entscheidungen ein. Zu den vorgeschlagenen Innovationen gehört u.a., dass EU und Mitgliedsländer sich künftig die Kosten für breitbandigen Internetanschluß von Schulen und Hochschulen teilen, womit die Idee einer Kommunikationsgemeinschaft ihren digitalen Ausdruck fände. Zudem sollte man mit Blick auf die Haushalte auf EU-Ebene ein Konzept für digitale Universaldienste definieren. Die persönliche Bündelung eines hohen politischen Amtes und von erheblichem Einfluß in den Medien sollte grundsätzlich in der EU ausgeschlossen sein, weil sonst die Gewaltenteilung unterminiert wird. Als Bestandteil der persönlichen Freiheit gerade auch älterer Menschen sollte sichergestellt sein, dass Senioren sich unabhängig vom Alter bis zur Hälfte der regelmäßigen Wochenarbeitszeit zu Erwerbszwecken betätigen dürfen. Die Verantwortlichkeiten der Tarifparteien in der EU sollten in der Erwartung gestärkt werden, dass Gewerkschaften und Arbeitgeber durch ihre Entscheidungen hauptverantwortlich für den Beschäftigungsgrad sind. Sollte jedoch die nationale Arbeitslosenquote 10% in zwei aufeinanderfolgenden Jahren übersteigen, dann kann die Regierung eines Mitgliedslandes die Tarifautonomie für maximal fünf Jahre beschränken. Die Regierungen aller Mitgliedsländer werden verpflichtet, Statistiken über die regionale und vertikale Lohndifferenzierung regelmäßig zu veröffentlichen. Was budgetäre Regeln angeht, so sollte auf der supranationalen und der nationalen Ebene bei jedem Gesetz eine mittelfristige Kostenabschätzung mit Blick auf den Staat einerseits und den privaten Sektor andererseits erfolgen. Im Fall einer schweren Rezession – nicht bei einer normalen Rezession – soll eine durch Mehrheitsentscheid im Ministerrat herbeigeführte Koordination der nationalen Fiskalpolitiken möglich sein. Alle Länder könnten eine zeitweise Erhöhung der Abschreibungssätze, eine Prämie für laufende Investitionen – relativ zu einer Referenzgröße vergangener Investitionen – vornehmen; oder aber die Steuersätze für die privaten Haushalte senken. Eine eigenständige EU-Steuer (auf Energie bzw. die nationale Arbeitslosenquote). Schließlich werden drei Vorschläge zur Verbesserung der Effizienz des politischen Prozesses gemacht: Im Interesse der politischen Stabilität der EU sollten die nationalen Wahltermine insgesamt so gelegt sein, dass in keinem Jahr mehr als die Hälfte aller Mitgliedsländer gleichzeitig eine nationale Wahl hat. Zusätzlich zu dieser institutionellen Innovation sollte man den Vorschlag erwägen, die Länge der Legislaturperiode beim Europäischen Parlament (und in nationalen Parlamenten) endogen zu verlängern: Wenn die Regierungskoalition wiedergewählt wird, verlängert sich die Legislaturperiode um ein Jahr. Mehrere Länder sollten im Ministerrat durch einen gemeinsamen Repräsentanten vertreten sein können; wenn sich mehr als drei Länder zu einer Vertretungsgemeinschaft zusammenschließen, dann steigt bei Mehrheitsabstimmungen das kombinierte Stimmengewicht dieser Länder um 10% gegenüber dem Fall einer isolierten Stimmabgabe. Diese Maßnahme soll Entscheidungseffizienz sicherstellen. Im Anhang wird ein modifiziertes Downs-Modell vorgestellt, in dem ein Zwei-Parteien-System nicht zur vollständigen Angleichung der Parteiprogramme führt – damit kommt man der Realität nahe.

## 1. Introduction

A constitution is a set of basic rules typically based on a broad social consensus and is assumed to define **long-term rules and institutions**. Thus changes in the constitution are normally rather difficult to achieve – e.g. because of high majority requirements. A high majority is supposed to be necessary for constitutional changes since the legitimacy of the constitution would otherwise remain weak. Indeed, the constitution of a society should reflect fundamental values and basic consensus in key areas; the latter could include principles with respect to the demarcation between state and market. Moreover, a constitution should establish basic institutions that are political frameworks within which one can solve current economic, political and social problems in an efficient manner. In a federal state – and in a union of member states such as the EU – it will also be important to assign political responsibilities to various layers efficiently and to ensure that institutions work smoothly (even in a Community of more than 20 member countries).

As regards federal states there is little doubt that the monetary order, security issues and foreign policy plus a minimum degree of fiscal policy must be assigned to the highest policy level. As the EU is not a federal state, one may doubt that a common security policy and a common foreign policy at the EU level is indispensable, but the **incomplete overlap of EU membership and of NATO** – which is a US-led international organization – leads to some unpleasant questions. Moreover, the Maastricht Treaty, which allows Denmark an opt-out clause has created a doubtful precedence for monetary union. In addition, sharing benefits and freedoms normally requires a fair sharing of obligations and burdens.

**Democracy, the rule of law and a market economy** are natural ingredients of prosperity and stability in OECD countries. This holds in particular for countries in Western Europe and the EU, respectively. The **economic core of the EU** is

- the European Community (Single European Act, Single Market, Economic and Monetary Union)

Thus in 2002 the EU Acquis Communautaire enshrined rules in key economic areas such as competition policy, monetary and fiscal policy. The EU constitutional convention will have to take stock of the existing body of rules and come up with a proposal for what could be a constitution for EU-15 and for EU-x in the future. The political core elements in EU-15 in 2002 were:

- Common Foreign and Security Policies which, however, were rather weakly defined.
- Moreover, there is the field of Justice and Home Affairs which includes immigration policy and judicial cooperation.

A distinct feature of any constitutional assembly at the beginning of the 21<sup>st</sup> century is that it must take into account the new reality of the **internet and digital communication**, which will not only affect business and modern administration; it also creates a new reality in the media sector, and it could open up new options for democratic government, becoming an important means for political debate and enhanced transparency. A framework for a **Common Communication Policy** could

be integrated into a consistent constitution of the Community. Digital communication will be part of everybody's life in the 21<sup>st</sup> century, and it would be useful to have a core element of communication policy as part of the *Acquis Communautaire*: as a field of positive individual benefits which is more visible than invisible trade creation benefits associated with the single market; and more popular than the special benefits accruing to minority groups such as farmers and people in disadvantaged regions which obtain funds from EU agricultural policies and structural funds, respectively. Moreover, the international network effects typical in modern communication make digital communication policy a natural field of EU activity. Only if ordinary EU citizens are able to identify personal benefits from integration – such as a stable Euro and a common communication policy – will there be popular long term support for EU integration.

Another distinct feature of the Community in the 21<sup>st</sup> century is that there will be the **long-term problem of an ageing society** which will entail many social and economic issues. A forward-looking constitution should certainly focus on some key issues associated with ageing.

Economists (eg MUELLER, 2002) have emphasized the importance of the constitutional design for economic growth and stability for many years. Government should design an institutional framework so that voluntary actions of individuals can achieve individual well-being and prosperity; government has a role in the provision of public goods, it also should help minimizing transaction costs so that there could be a Pareto-optimal allocation of resources.

Taking into account the ideas of RAWLS (1971) the constitution might also envisage principles for maintaining **open competitive access to positions in government**, moreover there could be some **redistribution mechanisms** that would make sure that the least advantaged strata of society also will benefit from economic growth. RAWLS (1971) has argued that individuals could agree on such redistribution rules on the basis of a hypothetical veil of ignorance with respect to their future position in society. One might apply this idea *mutatis mutandis* also to the position of member states in a union, so that redistribution mechanisms could be established which would make sure that the least advantaged member state also benefits from overall growth. Naturally, economists always will emphasize that contractarian rules should take into account incentive effects so that all individuals are encouraged to actively contribute to rising real income – thus politically organized redistribution can be minimized; this does not rule out, however, voluntary acts of redistribution in society. A crucial principle for designing a constitution is to set incentives for policy makers that the rules of the constitution be respected (eg there must be sanctions against corruption).

By defining the economic order in many fields (e.g. for goods markets, for media and news markets, for trade) – that is by establishing a basic set of institutions and rules within which individual freedom can unfold – the constitution can stimulate long-term economic transactions. Only in a country where individuals



have a long time horizon can one expect high investment and therefore high economic growth.

The **key elements of the constitution** are the political order and the economic order. The latter must define the division of powers (see diagram) and should anchor the rule of law in combination with a framework for the judicial system. The economic order consists of the following elements:

- **system of planning** (centralized versus decentralized – the latter implying a market economy in which firms plan individually and in which individuals are allowed to establish a company)
- **Property rights**
- **Forms of firms** (e.g. joint stock company)
- Aspects of **information society** – including media laws: The respective rules are quite important, as the media and public opinion, respectively, are part and parcel of a modern democratic system of checks and balances; public opinion and the mass media, respectively, have rightly been dubbed the fourth pillar in the division of powers. The internet gives a new relevance to the information subsystem.
- Aspects of the **monetary system**
- **Budgetary principles** (e.g. rules for deficit-GDP ratio or for maximum debt-GDP ratio)
- **Competition order**
- **Rules for lobbying groups** (transparency rules)
- **Environmental subsystems**
- **Principles of activities in international organizations**, including perhaps military alliances; moreover, there could be rules for membership in international organizations.

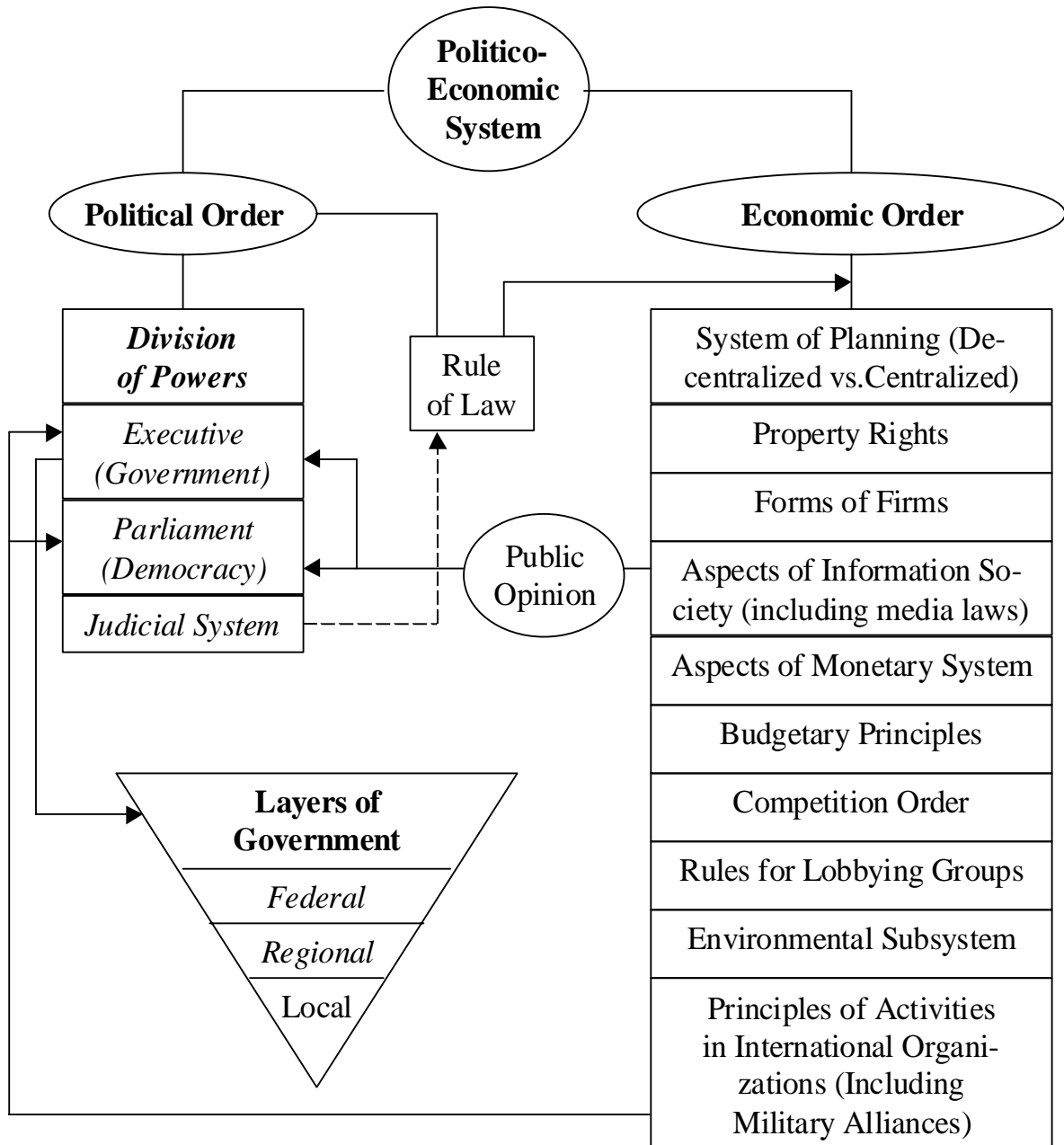
### *Government Layers*

In a federal system the politico-economic order is rather complex since there might be specific rules at the state level; they could pertain both to the political order and to the economic order. The principle of subsidiarity – accepted in the EU as a guiding principle for the allocation of competences across vertical layers of government – clearly calls for leaving some constitutional autonomy to the states. A strict version of limiting EU competences is to stipulate – as the US constitution does – that the EU supranational competences must be explicitly defined: Whatever is not clearly assigned to the supranational level will fall in the realm of the member states.

With regards to the European Union, the supranational level must respect core principles of the constitutions of individual member countries. The founding countries of the EU probably enjoy some privilege over young member states, since the pioneering founding members developed the first supranational institutions and policy rules which naturally should be consistent with their national constitutions.

Young member countries will have to adjust their national constitutions in order to qualify for EU membership, that is to comply with the Acquis Communautaire.

**Fig.: Key Elements of Constitution**



## 2. Quality of Political System and Power

If there is efficient competition among political parties in a democracy, one may expect a high quality of the political system, namely in five respects:

- ability to solve current (external) problems at low cost by applying the relatively best available solution to a given set of problems
- policymakers avoid causing major economic or social problems themselves
- ability of policymakers to come up with policy innovations that help to achieve a given set of problems at lower costs in future than current policy options would allow
- ability to maintain the social consensus, thereby avoiding unnecessary and costly changes in the constitution
- ability to serve as a role model for other countries: if other countries imitate the constitutional design this should facilitate international cooperation and international network effects which in turn will help the country to pursue its interests in the international arena.

An efficient political system that meets these five above-mentioned criteria will achieve increased output growth (and a rising ratio of wealth to GDP), and the rising share in world GDP will in turn cause a real appreciation of the currency. Higher output growth will imply that the country becomes a more important trading partner with other countries, in turn reinforcing the international role of the country in question.

A real appreciation alongside a rise in real output growth will weaken net exports of goods and services to the extent that the composition of exports exhibits high price elasticity. However, a real appreciation also makes acquisition of firms abroad cheaper in a world of imperfect capital markets (FROOT/STEIN, 1991); to the extent that exports – of intermediate products – are a positive function of the outward stock of foreign direct investment (FDI), the accumulation of capital abroad will stimulate net exports. A priori the net effect of the appreciation on net exports is unclear.

An increasing share in global outward FDI will contribute to economic and political power. Finally, a long-term tendency towards appreciation will bring about lower real interest than abroad, which should stimulate growth and contribute to a higher wealth-GDP ratio since all future income streams are discounted with a reduced real interest rate. Even if there is a negative effect of the real appreciation on net exports there could be a positive overall effect on output, namely to the extent that the rise of the net wealth-GDP ratio will strongly stimulate consumption or domestic investment.

### 3. Imperfections in the Market for Political Competition

Following Schumpeter, economists have applied the market paradigm to democracy: Political parties are viewed as political firms that offer alternative products – an election program and promised state services, respectively – at different prices (read tax burdens). Voters are on the demand side; by forming specific lobbying groups they might gain influence beyond simply casting their respective votes on the election day. In the following analysis we go beyond Schumpeter and emphasize some elements of political competition in democracies which are important for the efficiency of the political system, and there are crucial implications for the constitutional design.

In the Economics of Information, three different categories of goods can be distinguished:

- **inspection goods** – those whose quality can be easily assessed by potential buyers (say, strawberries) so that competition between private firms will lead to an efficient outcome;
- **experience goods** – require considerable informational resources if their respective quality is to be assessed adequately (e.g. holiday trip); recurrent purchase could help to get a clearer picture about the typical quality to be expected by certain firms. Moreover, one could learn from friends and family members who bought similar products which firms offer a high quality at a fair price. Standard competition processes can be expected to work in the medium term;
- **confidence goods** – quality is very difficult to gauge in the medium term. Indeed, one typically needs many years to make a clear assessment of the quality of the respective “product” (eg the political system). Only if producers have an incentive to think long-term and if there is broad transparency of proxies of the quality of goods can high quality then be expected. Without prudent regulation, there is a risk of serious market failure in the case of confidence goods; the competition process will lead to poor results as each firm/political party has an incentive to cheat on the quality of the product – while promising to deliver standard quality – as lower quality will go along with lower costs and higher profits respectively. We will apply the concept of confidence goods to the political competition process later.

Political parties (and in particular government with its policy measures) offer confidence goods in the sense that the election program and – on the side of government – real policy measures are difficult for voters to assess; the latter “pay” through casting of votes at the ballot. From a theoretical point of view government **policy represents to a large extent a public good**: There is nonrivalry in consumption and those not willing to contribute to financing policy measures can not be excluded from the benefits so that there is a potential free rider problem. The well-known problem of inefficiencies in the provision of a public good – partly related to unclear revealing of individual preferences, partly related to the free rider problem – implies the risk that the quality of policy will be rather weak. From a normative point of view financing of a public good should be based on individual willingness

to pay which in turn typically is positively related to income and wealth; thus a mildly progressive tax system is a rather convincing trait of a modern tax system.

The **political competition process** in a representative democracy largely resembles competition processes in markets. The quality of the political process sometimes is rather weak in democracies, and high uncertainty about “political quality” plays a crucial role in this respect. This uncertainty partly is related in the EU to high information costs for voters; high information costs to some extent can be explained by complex institutions and cumbersome consultations between the Commission, the Parliament and the European Council. A low turn out rate in European elections – declining over time – should be a warning to the EU which could face a declining political legitimacy. Reducing information costs in the political system and prudent assignment of EU competences are two necessary elements of an adequately designed political system. Voters must be able to recognize clear pillars of the EU project, and certain symbolic projects should help to contribute to a European identity.

From a voter’s perspective the most difficult policy unfolds at the supranational EU level where the Commission and the ever larger Council of Ministers plus the Parliament often are interacting in a complex and opaque way. Falling voter turnout figures in EU elections seems to indicate that voters in the Community find it rather unattractive to vote at all. Thus, the **political control at the supranational level** is apparently weak – and getting weaker all the time if no remedies are applied. With EU eastern enlargement, the already very large Council of Ministers is being further enlarged. Indeed, the number of representatives in a meeting of the Council of Ministers will be so large under standard EU rules that very cumbersome, lengthy and inefficient deliberations will have to be anticipated. Before a “Tour de Table” (each country representative saying good morning and giving a short statement) is completed, lunch will have to be served in an EU-25.

With respect to the Council of Ministers, all countries should be encouraged to form groups of at least two countries so that they be jointly represented; if a group is comprised of at least **three countries**, the combined weight of countries thus represented by one common representative is increased by 10% so that the number of people acting in the Council of Ministers will remain limited. This should help to ensure smooth and efficient deliberations.

A major problem of policy-making in the EU is the lacking emphasis on long-term problems and long-term solutions to problems. With this said, the efficiency of the democratic process can be improved by introducing a rule that a majority combination of re-elected parties should benefit from an extension of the parliamentary period, namely by one year. A longer parliamentary period would be seen as a reward for the successful political work of the governing coalition in the European Parliament (a similar option might be also realized at the national policy level). In this case the Commission should also receive a one-year extension. A scientific Council of Economic Advisers should be created within the Commission, and its annual report to the European Parliament and all national parliaments in the

EU should help to increase transparency in economic matters within the Community.

Political stability in the Community is important; one aspect that should be avoided is the simultaneous carrying out of too many national elections within the same year— typically a time in which government is more concerned with campaigning than with governing. The **election calendars** at the national level should be organized in such a way that not more than half of all member countries would hold a national election in the same year.

#### **4. Constitutional Design: Options for Rational Policy and for Improving Politico-economic Competition**

A prudently drafted constitution will help to improve the quality of policy-making, should contribute to politico-economic stability in Europe and inspire other countries in the world to envisage the adoption of some key ideas of the EU constitution (one might think about ASEAN in Asia or regional integration schemes in Africa and Latin America). The EU should have competencies whenever rules concern the single market and whenever major international external effects exist.

We now apply the above pattern of politico-economic order to the EU:

- **System of planning:** The EU is a social market economy in which economic freedom is guaranteed on the one hand and there exists an explicit goal of social cohesion across member states on the other, because very large income gaps would undermine political and economic stability in the overall union – e.g. internal mass migration and political radicalisation in backward member countries could undermine the stability of the EU.
- **Property rights and economic freedom:** private property rights are guaranteed in all EU member countries and thus should be enshrined in an EU constitution; state ownership should, however, not be ruled out since state ownership in some cases is adequate on a temporary or permanent basis (e.g. transitory state-ownership of banks during a massive banking crisis; a permanent system of state-run elementary schools). Basic economic freedoms should explicitly protect the right of elderly people to be gainfully employed for at least 20 hours a week with no age limit being imposed.
- **Forms of firms:** a broad array of options should be defined here. Digital virtual firms might require some special treatment in the EU constitution.
- **Aspects of information society** – including media laws: An EU constitution should avoid dominance of private ownership as well as state dominance in the media sector; takeovers from non-EU countries should be limited. There could also be principles of international reciprocity established: only firms from countries with no restrictions on foreign direct investment will face no restrictions on foreign investment in the media sector in the EU. Politicians in top government

positions should not be allowed to have a major stake in leading media companies since this would undermine the division of powers – broadly defined (namely including free speech) - and erode democracy. Since the EU should be a visible positive element for every citizen – at least in some stage of life – a consideration of the financing of broadband internet access in all schools and universities by the European Commission. This would indeed establish a creative digital communication community within the EU where all age groups could learn on the basis of high-speed communication, including cross-border communication. Budgetary costs for this learning-oriented common broadband access policy could be shared equally between the EU and member countries. Moreover, an important element of a common communication policy could be the definition of digital universal services that would establish certain rules for the provision of broadband network access (ADSL would seem appropriate, which implies asymmetrical high-speed capacity for download and upload communication – download capacities exceed upload capacity). Indeed, the EU should define a minimum broadband internet access requirement for households in all EU countries within a new concept of digital universal services.

- **Aspects of monetary system:** The Maastricht Treaty has defined most core principles for the EU and the Euro area, respectively. It seems impractical not to change much in the Maastricht Treaty, for it was complex to establish in the first place and seems to be adequate to handle future challenges.
- **Budgetary principles:** Here the Maastricht Treaty has defined some rules with respect to the deficit-GDP ratio and to the debt-GDP ratio of member countries. The stability and growth pact is an unclear element of the budgetary system in the Community, the idea of balancing the state budget in the long-term might be enshrined in the Constitution; e.g. through the stipulation that the budget position should be zero in at least one year of a five-year interval. In monetary union, there is natural harmonization of business cycles: Thus one also should establish a clear-cut mechanism for cross-border fiscal coordination on the basis of a qualified majority of countries, namely to the extent that fighting deflation and a massive recession in the Euro area are concerned. Another important rule contributing to rational decision-making is that all legislation at the EU and national levels must be accompanied by medium-term cost estimations, which should include budgetary costs – including reductions in tax revenues – associated with legislation and estimates for the respective costs to the private sector. Moreover, there should be cross-border coordinated fiscal policies in severe recessions – not in ordinary recessions; in a period of a severe recession all member countries could envisage a parallel transitory increase in capital allowances or an investment subsidy (scaled relative to past investment) for companies; or a temporary tax reduction for households. A special EU tax could have two pillars: An energy tax or CO<sub>2</sub>-tax which reflects cross-border negative external effects from the production process; plus a tax on national unemployment rates which would be a novel element – such a tax could be justified by pointing to negative international external effects from unemployment rates: higher unemployment will

reduce GDP and hence imports which negatively will affect opportunities to export in neighbouring countries. In order to avoid dissipation of scarce resources it would, however, be adequate to limit expenditures at the supranational level – a 3% expenditure ceiling could be such a limitation. An energy tax or CO2 tax should raise revenues of about 1% of GDP, member states would have to come up with complimentary financing. A supranational tax on the national unemployment rate should not so much generate revenues, rather it should stimulate countries to reduce the unemployment rate by adequate reforms.

- **Competition order:** Articles 81 and 82 (formerly 85 and 86) of the EU Treaty contain almost all necessary elements. However, there should be some additional rules guiding future international cooperation in global competition policy. With respect to the labour markets, there are obviously certain exemptions from the principle of competition: trade unions and employer organizations conduct collective bargaining and are supposed to fix wages and working conditions autonomously. However, the European constitution could stipulate that national governments can interfere in collective bargaining if unemployment rates in a member country exceeded 10% for two consecutive years; governments might impose wage caps and rules for regional or vertical (across skills) wage differentiation for a maximum of five years. Each member country should be required to publish a minimum set of labor market data, including data on regional and vertical wage dispersion.
- **Rules for lobbying groups:** The EU constitution should make sure that the public gets a more transparent impression from lobbying groups – which groups are active in Brussels and which firms or other organizations are members; a requirement to publish an annual report on the internet in at least three community languages might be useful.
- **Environmental subsystems:** Here the EU might want to enshrine some basic rules relevant for global and international environmental policy. The principle of subsidiarity should be emphasized here since politicians otherwise have an incentive to widen supranational competences in an efficiency-distorting way.
- **Principles of activities in international organizations:** This is a very difficult area, but given the growing global influence of powerful international organizations, one should consider new basic principles for an EU constitution: e.g. individual member countries with a membership on the board of an international organization might want to temporarily give up their national seat(s) in order to allow distinct EU voting on certain issues. Such a clause could become relevant only after negotiations with the major international organizations. FREY (1986) and TILLY/WELFENS (1999) have emphasized the growing long-term role of international organizations in the world economy.



### *Social Balance and Efficiency*

Historical experience testifies to the fact that a society will be stable only if there is political legitimacy, economic prosperity and a certain social cohesion. While a market economy with functional institutions and strict implementation of competition laws normally brings about economic prosperity social cohesion rests on two pillars: (i) voluntary social commitment of people, typically at the community level or in certain national NGOs – there is some risk that this important social commitment of individuals is weakening as society becomes more complex, urban and anonymous; (ii) government intervention – at various layers - through income redistribution and progressive taxation. The EU structural funds aim at contributing to social cohesion across member countries. A major problem is that anticipation of EU financial support will weaken regional and national efforts to achieve economic improvement, and there is even some risk that some weak regions would have made larger progress without Community support. To avoid and minimise such problems regular scientific evaluation, including benchmarking studies, are useful. Programmes should be tailored ex ante in a way that there can be scientific evaluation, and regional, national and EU statistics necessary for empirical evaluation should be collected in a consistent way. This reasoning leads to the proposal of a constitutional clause that all major EU programmes must be regularly evaluated where results should be published within no less than two years. Such evaluation should help to identify inefficient programmes so that funds from those programmes can be either given back to member countries and the taxpayer; or be spent on other programmes which let expect clear economic and social benefits.

A major problem of all modern market economies is that stock markets occasionally are characterized by speculative bubbles – eg the US in the 1920s and Europe and the US in the 1990s. Stock market bubbles are dangerous to the extent, that periods of excessive price/earning-ratios are likely to be followed by stock market depression (sometimes also with additional exchange rate overshooting). In open economies – characterized by fast and powerful communication networks – there is considerable risk of negative international stock market spill-overs. As restrictive monetary policy both in the 1920s and the 1990s was not successful in preventing the stock market bubble. It would be wise to have the option of a **transitory EU capital gains tax**. Imposing a community wide transitory capital gains tax in a period of incipient stock market bubbles could be useful to prevent large financial and real instabilities. The aim of such a tax cannot be to generate additional revenues; revenues collected should be put into an ECB escrow, the funds could be released during recessions by financing temporary corporate tax reductions.

### *Communication and Energy Security*

There will be several European pillars of economic prosperity. Two pillars are likely to gain importance in the 21<sup>st</sup> century. One aspect concerns the apparently

growing importance of communication; the New Economy and digitization, respectively, will strongly contribute to productivity growth and rising per capita income as already is evident from North America and several EU countries. The Community – reflecting efforts on the side of the European Commission and the European Parliament – has played an important role in opening up telecommunications markets in the EU. At the beginning of the 21<sup>st</sup> century one should envisage creation of a new EU institution, a European Community Forum in which regulators, industry representatives, trade unions and scientific institutions should cooperate: Publication of an annual report on the European Information Society and public discussion – disseminated via various channels, including the internet – should help to create a European vision of the information society and of a Common Digital Future in which networking among firms, NGOs and individuals will be crucial. A second pillar which could gain crucial importance in a community with sustained growth is energy security. The Community has emphasised the topic of energy security for decades – actually already within the framework of the European Atomic Energy Community. It would be useful to establish a permanent institution dealing with energy security issues, namely a European Energy Security Forum in which the Community, national governments, industry representatives and scientific institutions should meet regularly; this forum could stimulate a Community-wide energy dialogue and stimulate innovations in the field of energy security. Moreover, cooperation with European non-EU countries could be firmly anchored through such a forum.

A common (minimum) EU energy tax could be adopted within broader measures to fight global warming. Revenues from this energy tax should be the basis for financing innovation in EU countries, including projects related to energy efficiency.

## **5. Conclusions**

Constitutional issues are quite important for the EU, which faces with the risk of declining efficiency in political decision-making after EU eastern enlargement. An enlarged Community will face many difficult challenges in the era of globalization (WELFENS, 2002).

We have come up with a number of innovations and new proposals which should help to improve the efficiency of the political process. This in turn will contribute to economic growth and social cohesion, this in turn will reinforce the political legitimacy of the Community; and this will improve opportunities for the Community to pursue its interests in the global arena. Maintaining a viable Community is not only important from an economic and political standpoint, it also is decisive for maintaining peace in Europe. From this perspective, the constitutional decisions to be taken are quite important for the whole of Europe.

An open question concerns the issue of whether referenda could play a crucial role in the EU – a proposal raised by SCHNEIDER (1999). The fact that holding regular referenda is only found in Switzerland does not imply that the EU should easily dismiss this element of political decision-making in all policy fields. We leave this question open for further discussion.

Systemic competition in the triad should help to bring about piecemeal changes in policy-making and in the constitutional field in the long run. The EU should also exploit EU-internal systemic competition by leaving considerable fields of political decision-making to the member states. A major psychological problem among large member countries could be that they are “naturally” reluctant to learn from successful reforms in smaller EU countries. Publication of regular benchmarking studies by Commission services might therefore be another transparency requirement enshrined within the Constitution.

Finally, the EU policy stance in international organizations is unclear. Every five years, the EU should publish summary statements (minutes of the meetings) of all EU declarations at major international organizations in the internet. Many political conflicts over the role of the EU – including in the globalization process – might be avoided simply by making the policy stance of the Community plus the underlying core arguments more clearly known to the public.

The convention of the EU faces enormous challenges in a rather short period. It should consider the issues raised and make wise decisions. The EU must not fail in the 21<sup>st</sup> century.

### *Appendix: Two Party Models of Democracy*

In a two-party democracy model there are two parties competing for the majority of voters (party systems with complex coalitions can be dismissed from consideration here since we are striving to emphasize some fundamental ideas). We can plot the frequency of ideological preferences of voters in a simple left-right diagram. The DOWNS model suggests that competing parties will end up with an identical party program since the median voter's position ( $M$ ) is decisive for winning 50% plus 1 vote. This model is rather unrealistic since it assumes an equilibrium situation in which both parties are identical, although they would then have no identity. The left party's program would establish the party in  $M$  as would the right-wing party, and this contradicts reality and the need of each party to portray itself as a distinct identity. One should not overlook that party activities and the mobilization of party members – worker for zero wages in the campaign – is quite important for the acting government (and for the opposition group, of course).

Party members have more extreme political preferences than the average voter, so that a left-wing party – or right-wing party - has indeed an internal left wing and an internal right wing. “Investment activities” of party members will have – as we suggest – a positive rate of return in the form of obtaining a leading political position after an election victory; or party members derive special benefits in the form of quasi-consumption, namely the feeling to be member of government at present or in the future.

The original DOWNS Two-Party-System assumes that political competition will stimulate both parties to adopt a political program which corresponds to the median voter whose position in the ideological spectrum splits 50% left-wing voters from 50% right-wing voters. The traditional DOWNS model, however, is not convincing, since voters could no longer distinguish between the two parties – and party members would have hardly any reason to actively support his/her respective party.

In a modified version of the basic DOWNS-model we can assume that each party will have a distinct long-term party platform and a medium-term election program. Party members' political preferences can be characterized by a normal distribution – as we assume here – as can be voters in the overall population. A more realistic dynamic two-party model would assume that each political party combines traditional elements of the party program with some programmatic innovation – sometimes also organizational innovation. A dynamic influential campaign of a right-wing party would create a shift of the median voter position to the right ( $M_1$ ) and also achieve a shift of the median preference of the members of the right-wing party ( $R_1$  instead of  $R_0$ ). By contrast, a successful election campaign of a left-wing party would shift the ideological preference of the voters' medium position to the left ( $M_2$ ), simultaneously shifting the medium position of the party members of the left-wing party from  $L_0$  to  $L_1$ . The implication of our new modified two-party model is that a change in government will indeed correspond to a shift in the political program, namely from  $M_1$  to  $M_2$  in the event that a left-wing party wins the election,

thus replacing the old right-wing government. By contrast, the traditional DOWNS model implies that there will always be a political program  $M_0$ ; in the DOWNS model there is no convincing reasons why different parties would exist in the long run. The frequency distributions of voters and of party members fully overlap in the elementary DOWNS model, however in the following we will assume the party members have distinct position within the ideological spectrum (left, right).

Fig. A1: Elementary Downs Two-Party-Model

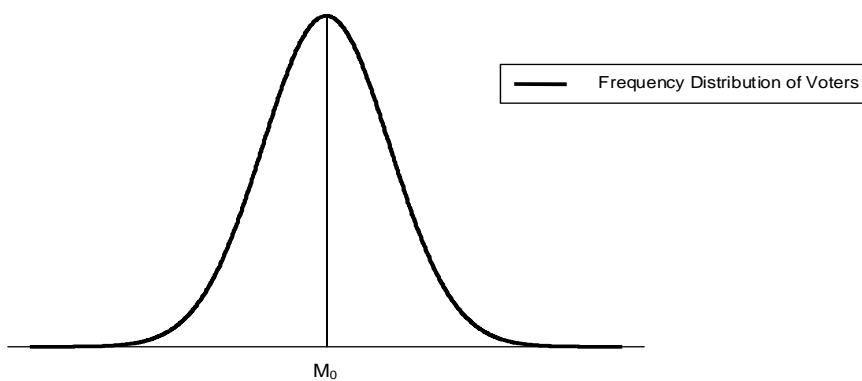


Fig A2: Basic Downs Model of Two-Party-System

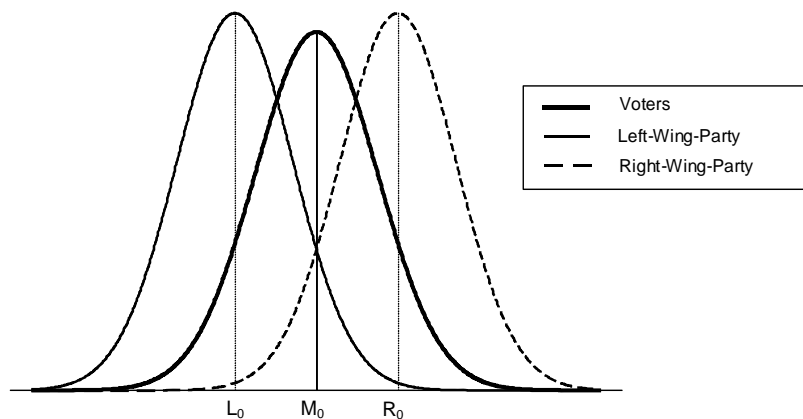


Fig A3: Modified Two-Party System with Right-Winner

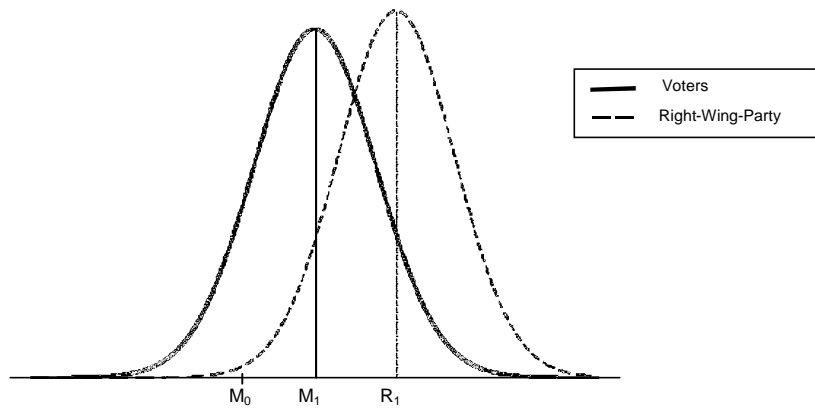
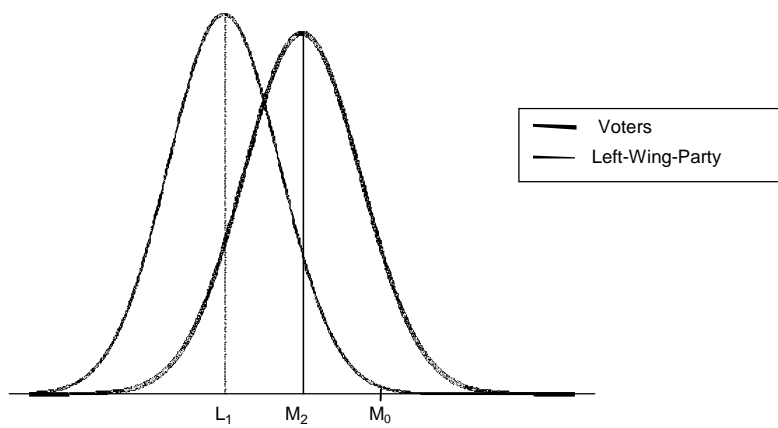


Fig A4: Modified Two-Party System with Left-Wing Party



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