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Introducing fiscal federalism in the EU

A way to counteract the democratic deficit?

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Abstract

The member states of the European Union face a two-fold democratic challenge; both from the increased relevance of global economic forces and because of the gradual strengthening of a still democratically deficient EU. By using a mixture of empirical findings and theoretical analysis to assess the causal mechanisms likely to ensue, the ability of European fiscal federalism to ameliorate this situation is assessed. Granting the EU fiscal competences could serve both to bring some currently footloose economic forces under shared democratic control and to alleviate the union's democratic deficit by encouraging new types of political contestation. One of the union's democratic problems is that the elections to the European parliaments are primarily fought by national parties over national issues, and granting the EU a core set of fiscal competences could, as it has in established federations, contribute to a more coherent party structure and to more substantive, issue-based electoral campaigns.

Key Words: European Union, democratic deficit, fiscal federalism, scientific realism

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Introduction

In the early 21st century it is increasingly apparent that European nation states are gradually losing democratic control over fiscal policy making. Fiscal policy, primarily comprised of public spending and taxation, has long been a hallmark of the nation state, but the capacity to wield it in a sovereign fashion has now been noticeably circumscribed by economic globalisation and the increased power of footloose international capital (Stiglitz 2006: 9). The powers ceded to the European Union (EU) in the area of fiscal authority are noticeably constrained, which is understandable given the political sensitivity of the policy area. Still this is a noteworthy state of affairs given that it makes the EU the only monetarily empowered entity that lacks fiscal competences, and this fact is likely to have salient corollaries for both the politico-economic and the democratic workings of the union (Hansson 2011: 167). In fact, it can be argued that the union's fiscal shortcomings affect both its institutional and societal democratic situation, and thus directly contribute to the so-called democratic deficit. The purpose of this paper will thus be to move existing debates on fiscal federalism and democracy in a new analytical direction, by exploring how the EU's democratic deficit would be affected by the granting of fiscal competences to the union. In order to do so, however, a firm grounding in the theories of fiscal policy, democracy, and the EU democratic deficit is required, and an original application of social science research methodology will also be needed.

Firstly, then, the burgeoning field of fiscal federalism will be looked into. It can shed valuable light on the effects emanating from the EU's lack of fiscal powers, because under the auspices of this field much analysis of both the economic consequences of different fiscal set-ups and of the interplay between politico-economic workings and democracy has been carried out. The politico-economic effects of fiscal policy are clearly relevant in their own right but will here primarily be dealt with insofar as they impinge upon the institutional and societal facets of democracy. Although not a federation, the EU has both monetary powers and a degree of economic integration that render it similar to formal federal entities in certain relevant respects, and the insights gained from this field can therefore be meaningfully applied to the EU as well. Findings garnered here have pointed firstly to that monetarily integrated actors tend to need to cede at least some fiscal powers to deal with asymmetric shocks, since the tools available at the level of the constituent governments are generally ineffective in dealing with substantial economic slumps (Baimbridge & Whyman 2004: 2). Some type of redistributive mechanism is therefore held to be needed, which is a claim that

can be both theoretically substantiated in fiscal theory and practically visible in the aftermath of the latest financial crisis (Seyad 2011: 97).

Studies in fiscal federalism have also pointed to how highly mobile economic units, such as corporations or high income earners can be difficult to tax adequately if powers of taxation do not lie with the geographically most wide-spanning layer of government (Oates 2004: 18). This is because the high degree of economic integration significantly lowers relocation costs, and the possibility for these actors to use the "exit option", should the yoke of taxation grow too arduous, serves to constrain what is politically feasible for governments to decide. European economic integration and the establishment of the single marker have thus significantly impinged upon and circumscribed the practical political options open to the member states, which is a trend then further reinforced by process of globalisation (McCann 2010: 30-31). It would therefore be worthwhile to investigate whether the introduction of fiscal federalism into the EU machinery could serve to counteract some of these effects, by extending the scope of political control in relevant areas so that economic actors lose their current territorial advantage. The questions then arise how this would operate and what elements of fiscal federalism would be needed, but the general point is still clear that the EU has the potential to enact policies no longer open to national governments.

These effects are primarily of a formal political nature, since it is about legally shifting powers from one level to another and thus extending the scope of political control. The introduction of fiscal federalism into the union would, however, not merely be a legalistic change, but could also serve to inspire new political allegiances and a new democratic awareness among the peoples of Europe. On a national level fiscal matters have tended to be core topics of debate in electoral campaigns and are usually the main dividing lines between the political parties (Gustavsson 2011: 32). This leads to a kind of political competition that inspires debate and mobilises the masses, and the EU's lack of such salient powers could contribute to the lack of public engagement in elections to the European Parliament (EP). The EP elections are currently the only direct source of popular input into union, but since political parties tend to treat them as second order national contests, rather than as genuine opportunities to affect the European policy agenda, and since there is little cross-European popular deliberation on political issues facing the EU as whole, their democratic standing can be questioned (Follesdahl & Hix 2006: 551). These problems are part of the so called "democratic deficit" facing the EU, and given that fiscal policy fills many of the functions in national settings that are missing on the European level, it seems worthwhile to investigate

whether it could play a similar role here. This would then have to be measured against the democratic costs of relinquishing governments of some of their formal powers and of moving some decisions further away from national electorates (Bohman 2005: 304).

This theoretical set-up poses some interesting methodological challenges. Firstly, the key concepts, such as fiscal federalism and democracy need to be explored and defined. Fiscal federalism is primarily a formal term, referring to a situation where different vertical layers of government have ultimate authority over different aspects of fiscal policy, but it is less clear how this can be translated into a European context. Democracy is, however, a far more difficult concept to uncontentiously define and operationalise, and this will receive ample attention later in the paper. For now suffice to say that democracy will be treated as an inherently two-sided phenomenon, where formal institutional conditions, and informal social conditions, such as deliberation and a shared communicative space, are both seen as indispensible (Eriksen & Fossum 2007: 8). Ensuring political rule through popular will requires both a formal set up of accountable institutions that have a balanced division of power, and a type of civic organisation where information levels are high and public deliberation thriving. Without knowledge and popular debate informed political decisions about how to utilise the web of formal institutions cannot be made, and these two facets are therefore fundamentally intertwined and essential for genuine democracy.

In this paper party competition will be used to operationalise democracy, since it seems to capture many features crucial to the research idea (Gerring 2001: 43). Party competition is tied both to the make-up of the formal political system, to the nature and extent of public deliberation, and to fiscal matters, and changes in this can be therefore be used as a way to ascertain the effects of the independent variable (Thorlaksson 2005: 2). Another salient methodological challenge is the fact that the phenomenon to be investigated has not yet happened, which effectively prevents the use of most standard social science research methods geared at explaining the co-variation between dependent and independent variables. Therefore the so-called congruence method and a scientific realist methodology (Pawson & Tilley 1997) will be adopted here. The congruence method seeks to combine an empirical setting, the introduction of an imaginary variable, and a deductive analysis comprised of theoretical arguments and empirical insights in order to ascertain the effects of the independent variable (George & Bennett 2005: 181). The last step thus relies both on predefined theories and understandings of the causal process likely to ensue gained from investigations in the situation in other contexts.

This shows why a scientific realist methodology is valuable here. The topic does not allow for correlational analysis, since the dependent variable has yet to occur, and full-blown comparative case studies hold limited utility given that the EU is a sui generis context exposed to a sui generis situation (fiscal federalism has never been introduced as an independent policy, but rather been part of an overarching federation package). By focusing on specific steps of the causal process, rather than on the relationship in its entirety, important information for the third step of the congruence method can, however, be gained (Gerring 2007: 172). The effects of different types of fiscal federalism can be investigated in existing federations, and the role of fiscal policy in structuring party competition and inspiring public deliberation can also be looked into. The insights gained here would then have to be built upon by theoretical models e.g. fiscal federalism (Oates) and participatory democracy (Follesdahl & Hix 2006 ; Barber 1984). These models can also provide the yardstick against which the results will be measured.

Research purpose and outline

The goal of this thesis is thus to present a new take on the democratic deficits facing the EU and its constituent member states by synthesising existing academic discussions and moving them in a new direction. Various theoretical insights gained from existing debates as well as results from previous studies can be used at various stages of the research process, but the fact that the explicit linking of the lack of fiscal competences in the union and the democratic deficit it is facing has not been explicitly made before means that new intellectual ground needs to be broken. Some conclusions, e.g. on the formal political changes bound to ensue, can be more safely drawn than others, e.g. about ideational changes in civil society, but the view put forward here is that many outcomes of the analysis can be substantiated. Many of the results are by no means foolproof and cannot promise a certain percentage of probability, but if the research methods are used meticulously and scope of validity clearly delimited then deductively sound and empirically based light on complex societal phenomena can be shed.

The first part of this paper will delve into the depths of research methods. Epistemology, methodology and research strategy are given a rather lengthy treatment since the nature of the topic poses unique research challenges that make it necessary to justify methodological choices. Attention is then moved to previous research and the theoretical scene set by existing literature. As mentioned, there is no literature on the precise causal relationship suggested here, but much has been written about the constituent parts underpinning the hypothesis. I

will therefore deal in turn with fiscal federalism, democracy, and with the notion of a European democratic deficit. Focus will then shift to theory, and in particular, since an overview has already been given in the literature section, to how theoretical models will be used to structure the deductive analysis that is part of the research strategy here. Theoretical accounts also provide ideal types (Weber 1994; Sartori 1973) that can be used to interpret and assess the findings of the preceding analyses, and thus hold an important evaluative function as well. This then prepares the paper for its second half where the actual analyses is carried out. This part is divided into the three steps of the congruence method, where the goal is to both theoretically and empirically outline the context and the proposed causal mechanisms in order to assess the eventual outcome.

The analyses carried out do in fact point to that many facets of the democratic deficits facing both the EU and its member states could be improved through fiscal integration. Some of the gains in formal public control can be more unequivocally outlined than the intricate and multi-faceted societal effects, but the argument put forward here is that clear democratic gains are visible in both areas. Importantly, fiscal federalism has been found to have effects in some of the areas where the democratic deficit is at its most notable, namely in the coherence of European political competition, the extent of public deliberation, and the second-order nature of EP elections. Although these effects would be neither automatic nor linear in their development, the view adopted here is that the overall result of the posited reform would be a net democratic gain; a gain which could ameliorate some of the salient factors underpinning the democratic deficit of the EU.

Chapter 1: Methodology

In this paper an attempt is made to avoid the epistemological extremes of positivism and post-modernism, while simultaneously trying to preserve their greatest respective insights. In line with positivism the view is here adopted that the goal of social science research is to uncover causal relations, and that empirical data can contribute to the attainment of this goal (Jackson 2011:6). In line with post-positivist, critical theory, however, contextual factors are here granted a greater importance than in traditional social science (Smith 1996:19). The middle-ground approach of "scientific realism" (Pawson & Tilley 1997) is therefore adopted here, but realism is not merely an amalgamation of other research positions, but also has some distinctive features that are directly relevant for present purposes. Firstly, much social science research has been more concerned with identifying overall correlation between two variables than with explaining how causality has operated. The causal process through which A leads to B and a theoretical exposition of why these steps were taken generally receive little attention, leading to a greater likelihood of spuriousness (George & Bennett 2005: 206). It could also lead to that in a particular context where A would lead to B but is hindered by the unknown variable C and any overt correlation therefore prevented, the existence of any causal relationship is rejected. Realism, in contrast, seeks to show that the independent variable has certain causal properties that propel developments towards the hypothesised dependent variable but that may or may not be triggered by the context. This means that more variation in the outcome is allowed for without a complete rejection of causality (Gerring 2007: 172).

Realism's prime focus thus lies on explaining how contextual factors and causal mechanisms interact to trigger the causal process, and it relies on both empirical measurement in its various kinds and theoretical analysis to comprehend the various facets of the causal chain. The focus is therefore more on causal generation than on statistical covariation, and more on explaining the process than describing the relationship (Pawson & Tilley 1997: 69). These core features are particularly valuable in the present case firstly because the dependent variable is yet unknown, and understanding the causal process is therefore of greater importance than would otherwise be the case. Secondly the realist approach also has the important advantage of allowing for within-case analyses of the causal processes in other contexts, even when a full-blown comparative case study might not be possible (George & Bennett 2005: 6). This means that insights into the causal properties of certain mechanisms

can be gained even if all the facts of the case cannot be translated to an EU context. Scientific realism is, however, not a panacea to social science ailments, since many of the traditional problems facing the discipline e.g. in regards to the operationalisation of abstract concepts, the choice of suitable indicators, and to the establishment of parameters within which the findings are valid, face realists as well (Landman 2008: 40).

Introducing the congruence method

The fact that the goal of the present study is not to explain a historically sealed off empirical event, but rather to foreshadow the developmental path of a political reform yet to be undertaken, has significant implications for the research design. Methodologically dubious though such an endeavour may sound, it is actually part of a well-established tradition within the social sciences. A number of historical studies, for example, have sought to investigate what would have happened had one of the salient variables in the case been different, and thereby tried to extrapolate future developments from a combination of a concrete empirical environment and a triggering independent variable. Examples of this include a study of the potential ramifications of a decision by Kennedy to send troops, rather than erecting a blockade, during the Cuba crisis, and whether granting the Nepalese Maoists a place in government would have prevented a civil war (Gerring 2007: 167). Such a thought experiment is included in what is known as the congruence method, where a concrete empirical environment (in this case the EU) is exposed to a new, imaginary variable (fiscal federalism), in order to investigate the effects on a particular phenomenon (democracy). A rigorous deductive analysis that combines empirical findings and theoretical reasoning to come to logically sound conclusions is therefore carried out as a last step (George & Bennett 2005: 181). The results of such an analysis are by no means foolproof and cannot promise a certain percentage of probability. Still, when used meticulously the congruence method can be an important intellectual tool and it can yield conclusions that can be both empirically and theoretically substantiated.

The epistemological framework of scientific realism and the research design of the congruence method are therefore deemed most suitable for the present research topic, and there are three main types of empirical information that need to be incorporated into the congruence method here. Firstly, the current workings and contextual environment of the EU need to be investigated. This serves as the basis for the rest of the study and must therefore be

carefully scrutinised. Here both the official fiscal and democratic competences of the EU and the practices of the societal European sphere need to be assessed, since it is not enough to be familiar with the formal legal and institutional conditions, if it is unclear how they are practically utilised. This is particularly relevant for democracy, since extents of public deliberation and interaction in the social sphere have a direct bearing on how well the formal provisions for democracy are utilised (Bohman 2007: 67). These two facets therefore work in tandem and should both be understood as setting the empirical scene onto which greater fiscal capacity is introduced.

Secondly, then, the variable of fiscal federalism is incorporated into the predefined empirical environment. Unlike democracy, fiscal federalism is a concept that can be rather uncontentiously defined, since it refers primarily to a formal, legal state of affairs, and can therefore be conceived of as a binary, all or nothing condition. If a country is made up of different levels of exclusive decision-making authority and some of the fiscal powers are vested in the central, country-spanning, government, then fiscal federalism is present (Oates 2003: 13). Still, there are different natures and extents of fiscal federalism, and the second kind of empirical information needed can therefore be gained from an analysis of the workings of fiscal federalism in established federations. Such factors include how power is distributed vertically and horizontally, which tools are used, and how fiscal policies are used in conjunction with other state powers e.g. over monetary policy (Morris et al 2007: 281 ; Schaltegger 2003: 161). Such descriptive information can be useful in showing the fiscal opportunities open to the EU, and can thus make the imaginary introduction of fiscal federalism more empirically grounded.

Thirdly, and finally, the deductive stage of the congruence method can greatly benefit from empirical material in providing ideas for the thought process and in shedding light on the causal processes likely to ensue. The causal properties of fiscal federalism can first be assessed. Ideally one would want the opportunity to go back to when fiscal federalism was introduced into the existing federations in order to separate it as a variable and ascertain its causal effects. However, since fiscal federalism was not introduced as an independent variable, but was rather part of an overall “federation package” its causal powers are methodologically difficult to distinguish (Landman 2008: 51). The second best option in this regard is thus to carry out a comparative analysis of the current effects of fiscal federalism in

the established federations. The main problem with this is that current federations differ from the EU in other ways than through their capacity for fiscal federalism, and that the existing studies that will provide the empirical background to the analysis undertaken here rarely devote direct attention to causal processes and mechanisms. Covariational, relational data must therefore be relied on here and then built upon through theoretical analysis. The previous studies of fiscal federalism that will be relied on here have primarily investigated the relationship between different types of fiscal federalism, i.e. a different balance of fiscal power between the decision-making levels of the federation, and socio-economic conditions (e.g. Snoddan 2003: 174). They have also focused on the role of fiscal matters in structuring the actions of political parties, which brings us to the matter of democracy (Thorlakson 2009).

Operationalising democracy

As will be looked more closely at in the literature overview, democracy lends itself less well to empirical classification than a formal institutional concept like fiscal federalism. This is firstly because it is tied not only to the make-up of the formal political system but also to social conditions such as information levels and the state of public deliberation. The investigatory problems stemming from this dual nature of the phenomenon are then further exacerbated by the fact that real life democracies are complex, multifaceted societies whose democratic workings are impinged upon by other societal provisions and forces (Carter & Stokes 2001: 1). This has led a number of researchers to opt for a minimalist definition when operationalising democracy by simply focusing on some of the salient formal institutions that distinguish democracies from non-democracies (Knutsen 2010: 111). These include Inglehout and Wezel's Effective Democracy Index, Vanhanen's Index of Democratisation, and others who pick a few quantifiable scores to measure whether competitive elections for political power are being held (Bernhagen 2009 :38). Given the theory of democracy that will be adopted here, however, such modes of operationalisation are too delimited since they use a categorical rather than scalar definition, and therefore do not allow for a measurement of the extent of democracy.

Instead an approach has been chosen with the three-folded goal of providing valid measures of both the institutional and social features of the concept, to allow for a graded assessment, and to shed light on the mechanisms of causality in the phenomena under study. With these

considerations in mind the nature and extent of party competition was chosen as a proxy indicator. Party competition seemed like a suitable choice because it is directly tied to both formal democratic provisions, since the nature and type of the democratic model has a direct bearing on the possibilities for party competition, and to societal conditions for democracy because of the role of party competition in channelling and provoking public deliberation (Thorlakson 2005: 2). Studies also indicate that fiscal matters, such as public taxation and the role of the state in the economy, are salient to voters in national elections, and thereby serve as an inspiration for public debate and deliberation (Gustavsson 2001: 32). The variable of party competition thus successfully integrates the three core facets of thesis and can therefore provide useful insights into the causal processes likely to ensue if were fiscal federalism to be introduced. The workings of party competition in some of the established federations and in the EU will thus be compared, with a particular focus on what kinds of party options voters have, what questions are dealt with, and how public deliberation operates. It will however be a contrastive analysis, rather than a strict comparative study, since an overarching stringent comparison of the phenomena in their totality will not be made, but rather a focused analysis of particular facets of party competition that are deemed relevant for the general argument.

Existing studies of electoral practices in the EU and in established federations will provide the lion's share of the empirical basis for this part, but will be combined with statistical surveys and some primary EU documents to give a more complete picture of the phenomenon. The sources of data utilised in these studies include election manifestos, roll call voting, expert opinions on party policy, as well as a range of indicators designed to measure the extent of public deliberation and the existence of a demos. The conclusions reached here are thus that a research design based on the congruence method should be coupled with a scientific realist epistemology in order to uncover and analyse the effects of fiscal federalisation. Although important methodological challenges are present, if the three kinds of empirical data are integrated into and built upon by logically sound theoretical analysis, new useful knowledge could be created and the democratic deficit facing the union more comprehensively understood. The results will then be measured against the yardstick of "participatory democracy" as defined below, in order to assess whether democracy in contemporary European societies would benefit from the formal introduction of fiscal federalism in the EU.

Chapter 2: Literature overview

Various aspects of the studies of fiscal federalism, democracy, and the EU's democratic deficit will be directly or indirectly relied on this paper, and this intellectual background therefore needs to be sketched out here. It can, however, also be seen as an introduction to the overall topics in order to lay down the parameters within which the subsequent discussion takes place, and this literature review will be used for those purposes as well. Even though the lion's share of the empirical analysis will also rely on previous research, an overview of this will left for a later part of the paper since here the focus will be on general theories and strands of the debate rather than on concrete empirical data. Introducing the concepts and phenomena is essential for the research because of their intricate and multi-faceted nature. Fiscal federalism is both an empirical phenomenon in a number of countries, a theory of how the economy can be organised, and a normative guide to how the economy, for economic, political, or social reasons, should operate. Democracy is, in turn, even more complex, in that the academic field is far broader and it is more difficult to pinpoint the boundaries between prescription and description. It should, however, be borne in mind that fiscal federalism and democracy are not the study objects of this paper, but are instead relevant insofar as they pertain to the EU's democratic deficit. They will thus be introduced here in a manner that serves the end goals of the paper.

Fiscal federalism

As mentioned in the introduction, for our purposes both the politico-economic and democratic sides of fiscal federalism are relevant, since they are strongly correlated in many instances. The field of fiscal federalism did, however, originate to theorise about the political economy of fiscal policy in federations and the main arguments produced here will therefore first be outlined. In a federation the separate layers of government have ultimate responsibility for different parts of the whole, and academic research has therefore focused both on how different degrees of fiscal centralisation affect the federation and on what kind of tools work best at each level. In general terms, three key advantages of fiscal federalism are mentioned (Oates 1972 ; Baimbridge & Whyman 2004). Firstly, a federal budgetary system that allows for transfers between the states is better equipped to deal with *asymmetric shocks*. The participating members have all (as is the case among EMU countries) sacrificed monetary sovereignty, which means that interest rates or money supply cannot be unilaterally changed, and fiscal tools must therefore be used to combat slumps or economic differences between the regions (Artis 2007: 275). If all were equally affected by a shock then the same

monetary policy could be prescribed, but if some states are affected to a greater degree than others, an automatic redistributive mechanism that transfers fund from better to worse performing states is generally deemed necessary in the literature (Vrousalis 2006: 183). The EMU remains the only monetary union that does not have a fiscal redistributive mechanism.

Secondly, centralising some fiscal powers would "internalise externalities". In brief, this refers to that many services paid for by the tax payers of one member state can also be enjoyed by others (Baimbridge & Whyman 2003: 2). Since mobility is free in a federal union and most aspects of the legal system are harmonised, it is easy for citizens to move to a new area and enjoy services to which he or she has not contributed, and it is also possible that investments in infrastructure, electricity grids, etc, spill-over into other states. Making a central body, to which all the states pay, responsible for such salient public expenditure, would ensure that those who benefit from a service also help financing it. And thirdly, having centralised fiscal policy could avoid unhealthy tax competition (Oates 2003: 17). On an integrated market it is difficult to tax highly mobile units, such as companies or high income earners, since the exit option is a constantly present threat. Given that laws and other kinds of formal and administrative conditions are similar within the economic area relocation costs are lower than between non-integrated actors, making it far easier to move should the weight of taxation feel too burdensome. In order to bring back these types of taxation under public control, it is preferable to include them in a higher a level of government, so that the principles of taxation cover the same area as that within which it is easy for the mobile units to relocate (Morris et al 2003: 287).

Even some of these general points are, however, contested. Gramlich and Wood argue that centralisation of tax rates is in fact not needed to avoid harmful tax competition, since inter-state harmonisation could achieve the same goal (2004: 122). Hansson also subscribes to this point, and adds that tax rates can be a competitive advantage, and has been actively used by, for example, the central and eastern European states to attract investment. Centralising tax rates would therefore remove one salient means for these budding economies to compete with "old Europe" (Hansson 2011: 189). In addition, neo-liberals argue that federal fund transfers are not needed for stabilisation, since markets that are flexible enough can correct themselves. So rather than centralising policy-making, instruments should be put in place that further freedom of movement and flexibility (Ackrill 2004: 112). From a different ideological

starting point Keynesians have put forward the argument that when states are different enough in their economic cycles, fiscal policy prescribed centrally is likely to be suboptimal. This line of reasoning applied to the EU would thus mean that since monetary policies have been surrendered through EMU it is even more important that the member states keep their fiscal independence so that suitable countercyclical fiscal policies can be prescribed (Vrousalis 2006: 191).

These arguments will be engaged with and assessed in the analytical section, but for now suffice to note that economic and ideological/normative considerations are not only conflated in the argumentation but also practically interconnected in many ways. One field of study has, for example, focused on how different types of fiscal federalism affect the competitiveness of elections and the ability of citizens to participate in the policy process, and this normative corollary of fiscal choices must also be borne in mind (Thorlakson 2007 ; 2009). Lastly it should also briefly be mentioned that a subsection of the literature focuses on what fiscal federalism would or should look like in the EU. In this field a general consensus that fiscal integration is necessary is discernible, but there are differing viewpoints, stemming from the different starting points in the field, on the degree of centralisation needed, how it should operate, and how it should be funded (Hansson 2011 ; Ackrill 2004 ; Gramlich & Wood 2004). Erecting some type of fiscal union could therefore potentially be justified on purely politico-economic grounds given the relative consensus in the field, but depending on its set-up and mode of operation different formal and informal corollaries for democracy ensue, and this totality of consequences must be taken into account when making a choice.

Some strands in the field of democracy studies

Even though theories of fiscal federalism differ in economic standpoints or normative underpinnings, the phenomenon as such is at its core a legal state of affairs and its existence is thus primarily a matter of formal definition. Not so with democracy, since the formal institutional set-up is not enough on its own, if the citizens do not have the knowledge and skills to use it adequately. Before engaging in this discussion, however, it should be mentioned that the field of democracy studies is too extensive to lend itself to a straightforward overview, but a few core tenets of it that are directly relevant for present purposes should be outlined. Democratic theory is made up of a complex mixture of descriptive and prescriptive elements, since it tries both to classify existing democracies and

to theoretically model a normative ideal towards which actual democracies should strive and against which their accomplishments can be measured (Sartori 1973: 4). Firstly, then, most commentators agree that a democratic system is essentially one where the people, who are politically equal and have similar abilities to obtain information, govern themselves through elected representatives (Dahl 2000: 37-8). In order to ensure that the government refrains from corruption and is responsive to the citizenry, a formal set-up is needed, that is characterised by e.g.:

- a division of power between the executive, legal, and juridical actors
- free, contested, and regular general elections
- a demos, and a delimited territory within which the elected representatives have the power to carry out the expressed will of this demos
- a legal framework ensuring basic rights and liberties, such as freedom of speech, freedom of association, and access to information (Carter and Stokes (2001: 1).

These basic cornerstones all need to be present to some degree for a state to be a formal democracy, and some commentators, keen on differentiating between democracies and non-democracies in a straightforward, easily operationalisable manner, have argued that a minimalist of definition of democracy comprised of these formal conditions is sufficient (Knutsen 2010: 109). A second strand in the literature has, however, pointed to that it is not enough that the citizenry has the institutional opportunities to govern themselves in a fair and equal manner if these opportunities are not adequately seized upon. In order for the people to make reasoned decisions about the future policy agenda of their polity they need access to information and a civic culture where such information is engaged with and debated (Feree et al 2002: 295). This means that in order for democracy to operate as intended social conditions are needed, such as:

- media that spread information and facilitate debate
- A process of public deliberation where opinions are voiced and changed
- the basics of a common identity, so that the people can engage in debate on equal terms and discuss similar matters with similar symbols of meaning.

Since democracy and policy-making are dynamic and ongoing phenomena the citizenry need to be socially involved enough to learn of new facts and to be exposed to new views, so that their own opinions can develop accordingly. So without genuine deliberation by the demos on

alternative policy agendas, rule by the people cannot be said to be carried out in any meaningful way (Hix 2005: 179). It should also be noted that this process of deliberation is simultaneously a gradual creation of community, since if people interact and debate on fair and equal terms they are also likely to see each other as co-creators of a shared future (Barber 1984: 19). A third strand of the literature on democratic theory argues that democracy is theoretically but not practically separable from other socio-economic phenomena, since people who are economically marginalised or socially excluded are also less able to take part in the democratic process (McGrew 2001: 274). According to this view researchers trying to operationalise democracy must take such socio-economic conditions into account in order to see the full scope of how democracy works in a given society.

Lastly, in this brief descriptive overview, it should be mentioned that there are strands of democratic theory that do not posit the sovereign nation state as the hub of democracy. These theories instead deal with international or transnational democracy and include schools such as liberal internationalism, cosmopolitanism, and deliberative democracy. These posit that democracy can be extended beyond the nation state through delegation of authority by democratically elected bodies, that all individuals have political rights which makes overlapping democracy through a supranational legal system necessary, and that individuals should have the possibility to contest or help shape all decisions by which they are directly affected, respectively (Held 1987; McGrew 2001: 273; Habermas 1986; Bohman 2005: 2). Relevant though these may seem for present the present topic, they are not theories of democracy per se, but rather theories about how to adjust the workings of existing democracies to respond to global developments. They thus focus more on extending national democracy by creating overlapping spheres of influence than on bringing about new hierarchical, territorially based structures of democratic governance. I therefore consider their ability to shed light on the effects of federalising parts of fiscal policy on democracy to be limited.

European democracy and the democratic deficit

The last strand of the literature that needs to be mentioned here deals with the current democratic situation in the union. This brings us to the debate about the so-called democratic deficit, which pertains directly to the effects I have posited of fiscal integration, and must therefore be dealt with in some depth. For simplicity’s sake the democratic deficit, like

democracy itself can be understood as stemming from two main problems that are of an institutional and civic nature. Firstly, in an institutional sense, commentators have warned that a general strengthening of the executive is taking place at the expense of directly elected representatives, i.e. parliaments (Hix 2005: 177). Executive agents, such as government ministers, can now make laws directly through the Council of the European Union without, in most cases, having to wait for the approval of national parliamentarians. This means that an important step in the national legislative process is by-passed, and power is thus evermore centralised in the hands of a limited number of executive actors. This gradual strengthening of the executive has also led to a legitimacy problem, since the EU has accumulated powers that the European people are still unwilling to cede beyond the polity (Weiler 1996: 8).

These problems are particularly troublesome given that the loss of power for national parliaments have not been sufficiently compensated for through the only directly elected body in the EU machinery – the European Parliament. The powers of the parliament have been strengthened, but are still limited in important areas, such as foreign policy, defence policy, the negotiation of trade agreements, etc. (TEU 14, 16 ; TFEU 218 ; Börzel & Hosli 2003: 192). The point has, however, repeatedly been made in the literature, that even strengthening of the European parliament would not solve the Union's democratic deficit, because the EU would still suffer from serious shortcomings in the second face of democracy. Elections to the European Parliament are not preceded by inclusive, EU-wide public deliberation, and the electoral campaigns tend to be concerned with the track-record of incumbent national governments rather than with genuine European issues (Hix & Marsh 2007: 496). If representatives in the European Parliament are not elected through actual electoral contestation where a fairly cohesive demos deliberates in order to decide on the future policy agenda, than their democratic standing must be put into question (Eriksen 2005: 342). It is thus clear that many of the societal features that were considered necessary for the civic side of democracy are at best underdeveloped and at worst entirely absent at the EU level.

Some have suggested, e.g. Moravcsik and Majone, that the EU does not suffer from a democratic deficit but from problems with accountability, transparency, and legitimacy (Moravsik 2002 ; Majone 2002). They argue that since the EU is a regulatory but not distributive entity (except for through the CAP and the structural funds) the general standards

of democratic legitimation do not apply. Commissioners are appointed by elected governments, council ministers are elected in national elections, and MEPs are directly elected, which suffices as democratic credentials as long as the EU respects the principle of subidiarity and does not overreach. The problems are therefore rather a shortage of transparency and the mental distance European citizens have to the EU, making them deem its operations illegitimate, which can be improved through greater transparency and improved communications. Greater input from civil society and possibly some shifts in the institutional power balance could also be used to counteract this legitimacy deficit, they argue (Follesdahl & Hix 2006). Vivianne Schmidt has also perceptively pointed out that the democratic deficit facing Europe is not just an internal part of the EU machinery, but increasingly also a feature of the nation states. The EU has now amassed substantial powers of effective functional governance, leading to that national politics is increasingly about abiding by regulations and transposing directive rather than about creating new law (Schmidt 2006: 1). This means that in the member states there is democracy but an increasing lack of actual capacity to ensure that the will of the people is translated into action. In the EU, Schmidt argues, the situation is the reverse, since here there are competences and functions but only scarce democratic processes that can turn a publicly developed will into policy (ibid: 223).

The argument is thus made that European democracy is deficient both because the EU itself suffers from democratic shortcomings, especially in the societal side of democracy, and because the member states have a gradually decreasing ability to carry out the will of their citizens. Interestingly completely contradictory solutions to these problems can be posited, since EU democracy can benefit from a strengthening of European competence so that voters find it relevant to deliberate on its future policy agenda, whereas such a development would further hollow out national capacity. Although by no means complete, this overview of general arguments in the literature should show the questions at stake and thus the relevancy of the research field. This overview should, however, also point to that an explicit merging of the insights of the different fields is still missing, which means that the causal potential of fiscal federalism to act as a catalyst for an alleviation of the democratic deficit has not been engaged with. The goal of the present paper is thus to move the debate on the European democratic deficit in a new direction by pointing to the role that fiscal federalism could play in overcoming the democratic shortcomings that have been identified in the field. Now attention will turn firstly to an analysis of the theoretical postulates outlined here, but also to a justification of the choice of the conceptual frameworks that will be used both in the

assessment of the empirical results and to provide guidelines for the deductive analysis to be carried out.

Chapter 3: Theory

Choosing a theory is not merely a matter of selecting the conceptual framework that one finds most intellectually convincing, but also a matter of successfully relating it to the purpose of the research and the availability of data. A choice must thus be made between descriptive, explanatory, and prescriptive theories, as well as between meta- and middle-range theories (Wiener & Diez 2009: 3). This thesis is built on a prescriptive theory of democracy and an explanatory theory of fiscal federalism. By outlining a normative ideal for democracy against which current practice can be measured, and by putting forward a theory of fiscal federalism that seeks to explain how different modes of fiscal policy affect societal democracy, an attempt is made to uncover the net democratic gain of introducing fiscal federalism into the EU. In this part of the paper different theories of fiscal federalism, democracy, and the democratic deficit are compared and contrasted in order to make a reasoned choice about the conceptual framework that will be used in the deductive analysis carried out in the final step of the research cycle. For the explanatory theory of fiscal federalism a mixture of empirical data and other considerations will be relied on to justify the choice of theory, whereas the prescriptive theory of democracy will be chosen primarily for theoretical reasons. Lastly, an understanding of the democratic deficit in the EU will be come to both by relying on empirical accounts and through its fit with the prescriptive theory of democracy opted for.

What is required from a theory of fiscal federalism?

Since fiscal federalism is primarily approached here from a politico-economic, rather than strictly economic, perspective, the exact economic consequences of different modes of fiscal federalism will not be explored in depth. The purpose of fiscal federalism here is firstly to achieve the general politico-economic effects described earlier, but secondly, and more importantly, to help ameliorate the democratic deficit of the EU. For these purposes it is not imperative to select a specific sub-theory of multi-level fiscal policy, since many of the advantages are inherent in the phenomenon of fiscal federalism as such. Still, a few basic choices of fiscal design based need to be made. Firstly, the neo-liberal idea that markets can and should be self-correcting is rejected here for both functional and normative reasons. As far as functionality is concerned, all currently existing entities with shared monetary powers have chosen to have centralised fiscal policy and redistribution, ostensibly deeming it practically necessary (Gustavsson 2011: 26). Moreover, studies have shown that the more diverse the economies of the units within a federation, the greater the need for central stabilisation measures (Patchey & Wells 2004: 150). Given that the EU is more economically

diverse than existing federations and given that the perpetual experience of enlargement is likely to make this a lingering condition, such measures are likely to be of even more relevance to the EU.

Normatively speaking, the positive effects on the various facets of democracy that stem from fiscal policy will not be achieved through a laissez faire approach, since the possibility of public input and deliberation would be limited. Such a set-up would therefore not allow for fiscal policy to be used to ameliorate the democratic deficit. A second choice made here is that the fiscal set-up should be of a centralised, rather than merely intergovernmentally harmonised, variety. This has been a subject of some theoretical contention in the field (even though all other monetarily integrated entities have opted for centralisation) since there are some advantages to harmonisation. Firstly, harmonisation and mutual recognition have been successfully pursued in other EU policy areas, particularly in the four freedoms (Craig & De Burca 2008: 835). Secondly, harmonisation would ensure that interstate fiscal competition could still exist, which some member states are using as their comparative advantage. It could also put pressure on governments to keep taxation and spending in check since they cannot rely on centralised redistribution mechanisms to bail them out (Schaltegger & Frey 2003: 156). And thirdly, opinion polls have indicated that the European public is generally opposed to supranationalism when it comes to fiscal policy, especially in regards to taxes and social welfare systems (Berg 2011: 125). Harmonisation would ensure that ultimate decision-making capacity would be retained by the member states and would thus remain geographically closer to the citizens.

However, fiscal federalism could primarily be about systemic conditions, rather than about individuals and their welfare, and funding for such a mechanism does not have to come from direct taxation, so this public unease is not necessarily applicable to all types of fiscal federalism. Also, given that many of the fiscal competences in question can no longer be utilised on a national level, granting the EU centralised powers would not so much remove national competences that would exist under a framework of harmonisation, as to create new possibilities to wield public power. And although harmonisation would prevent the worst kinds of a race to the bottom without sacrificing sovereignty, the empirical situation in the EU seems to indicate that it is ineffective. The stability and growth pact of the EMU seeks to bring the EMU members into fiscal harmony by limiting deficits, debts and inflation, but the

empirical record shows that countries tend to abide by these rules only prior to becoming members (Morris et al 2007: 209). After membership EMU members have performed no better on these scores than non-EMU EU members, and centralised mechanisms would therefore ensure a greater degree of coherence here. Moreover, making fiscal policy a centrally managed competence would also ensure that it is included in formal democratic processes. The fiscal situation in the member states is already strongly affected by EU economic integration and by the fiscal choices of other members, but the management of this situation is currently exempt from structured public control. Centralising fiscal policy would thus integrate fiscal policy into the democracy machinery and thereby also ensure that both political parties and the EU public could deliberate on fiscal matters in a way that would not be possible if negative integration and harmonisation were opted for. Centralisation can therefore be both functionally and democratically justified, because it ensures for coherence and compliance, and allows for inclusive European deliberation on matters that clearly go the heart of the European integration project.

A more precise outline of what this European fiscal policy would look like, how it would operate, and how it would fit into the EU institutional system will be given later. For now the two key underlying theoretical starting points that have been outlined and justified here are that a kind of interventionist fiscal policy is needed in the EU, and that this should be of a centralised kind decided upon through formal, European political procedures. These theoretical conclusions will then inspire more precise choices made on how this should be implemented in practice.

The basics of participatory democracy

The theory of democracy that will provide the normative ideal in this paper can be termed participatory democracy, and draws on general liberal theory, the so-called “strong democracy” theory developed by Barber (1984), and the on work of Hix (2005; Hix & Follesdahl 2006). Barber tends to be seen as an advocate of local, small-scale democracy, but his insights on the value and transformative potential of active involvement in the democratic process have a more general scope of application as well. The core premise of the theory of participatory democracy is the belief that the formal institutional conditions needed for democracy, such as elections, a division of power between the key institutions, equality and rights, need to be coupled with a socially active and educated citizenry in order to ensure that

the formal provisions are properly utilized. The goal is thus to have an active citizenry determining the future policy agenda, which means that formal conditions need to be in place that allow for this. If there is not a sufficient amount of relevant parties, and if they do not compete over the policy agenda in such a way that people have an actual choice about the future direction of their polity, then there are formal shortcomings that limit effective democratic rule (Hix 2005: 180). In the second, societal side of democracy, participatory democracy distinguishes itself from other theories such as majoritarian and representative liberal theories, by placing great emphasis on the process of coming to a decision, and not just on the decision itself (Feree et al 2002). People's understanding and views are not naturally fully formed, but instead change as a result of interaction and the information they are exposed to, which means that deliberation and debate are needed to raise the quality of the eventual decision. And unlike constructivist and post-modern theories of democracy, participatory democracy is based on the idea that although language and discourse matter, people are ontologically able to rise above discursively constructed power relations, and thus make reasoned choices. Inherent in participatory democracy thus lies the view that expressed public opinions can have a greater or lower quality depending on the extent of deliberation preceding them, and this directly effects how well the formal democratic institutions are used.

In the literature review it was mentioned that some scholars have also come to favour the inclusion of a third aspect of democracy, where social, cultural, and economic conditions are included since these exist in a covariate relationship with democracy. On the one hand this argument has empirical justifications, since education levels, income, cultural exclusion, etc, directly impact upon the individual's involvement in political processes (McGrew 2001: 274). But on the other this account focuses too much on individual level, rather than systemic, factors, and on factors that affect, rather than are, democracy. The concept cannot be defined so generally that everything is included firstly because it would undermine its utility, and secondly because of the ontological point that things in the social world can be granted a unique existence even if they interact and covary with other phenomena. Economic and cultural factors affect democracy but are not democracy, which distinguishes them from the civic democratic factors outlined above, since these are crucial and inescapable parts of the ability of a demos to govern itself. Citizens cannot make reasoned choices about their common future unless they have formed views through a deliberative process, and this must therefore be reflected in any conceptual account of what democracy is. European democracy

will therefore be assessed against the backdrop of this two-fold conceptualisation of democracy upon which participatory theory is premised.

Theorising the democratic deficit

Many accounts of the EU's democratic deficit, especially those following the influential British academic Simon Hix, do in fact share the same core premises as the theory of participatory democracy. They identify shortcomings firstly in the formal side of democracy, since the relative weakness of the EP and the direct decision-making capacity of executive agents serves to create an institutional unbalance that would not be accepted on a national level (Weiler et al 1996: 8). This is then reinforced by another institutional problem namely that the there are no relevant EU level parties competing in European elections on European grounds. Instead national parties compete in EP elections with predominantly national election platforms, and a European electorate is therefore institutionally prevented from engaging in collective deliberation over the future European policy agenda (Hix 2004: 195). Given that electoral turnout in EP elections is also abysmally low, 43% in the 2009 elections, and the fact that there are no European-wide media to ensure that the European electorate engages with the same issues, the democratic quality of EP elections can be strongly questioned (Eurobarometer 2009). This can also be linked to the debate on the European demos, since if the peoples of Europe have too varied conceptions of politics or if they are too mentally separated to see communication with everyone in the polity as politically necessary, this can directly hinder effective public deliberation (Schmidt 2006: 22).

These considerations and empirical findings provide direct counter arguments to other intellectual takes on the democratic deficit, primarily to those produced by Moravcsik and Mahone. Moravcsik's arguments that the indirect democracy through which the executive actors are appointed and the direct elections of the EP are enough to ensure satisfactory democracy seem to fall flat in the face both of empirical evidence and of the theoretical arguments produced above (Moravcsik 2005 ; Hix 2005: 177). Since neither the executive actors nor the representatives in the EP are elected on genuinely European grounds, and since no shared, educating process of European deliberation preceded them, they are found lacking in both formal and societal sides of democracy. Making the EU more accountable to a scrutinising media or more transparent would not affect this. And Mahone's insistence that that the EU is primarily a regulative and not distributive body and thus subject to other

criteria, can also be questioned (Mahone 2002). This is firstly because the EU is influential enough in how it impacts the European public to have its actions legitimised, rather than simply dismissed by putting them under the banner of “regulation”. Secondly, increasing the legitimacy of EU actions would not come about merely by a delimitation of its competences and the achievement of pareto efficient outcomes, since the key problem does not lie in the result of EU actions but in the process leading up to them. If people felt more directly involved in the process of shaping the European policy agenda through improvements in the formal and societal shortcomings in EU democracy outlined above, then its actions would most likely also be perceived as more legitimate (Eriksen 2005: 348). It is consequently more about reforming input democracy than about delimiting competences or reclassifying the union as merely “regulative”.

Participatory democracy is thus preferred as a theory of the democratic challenges facing the EU both because it draws attention to the formal and societal sides of the democratic deficit, and because it manages to incorporate a number of different empirical observations into its conceptual framework. Empirical studies have noted that the turnout to EP elections is significantly lower than that to national ones, that the electoral campaigns are of a “second-order nature” dealing primarily with national issues, that there is a relative lack of a European demos capable of deliberating on the same issues, and that European citizens feel distanced from the EU and deem it to be lacking in legitimacy (De Vries et al 2011: 17 ; Hix & Marsh 2007: 496) . Improving input democracy through formal and societal changes as described here is not a panacea for all these ills, but the arising of these problems can be accounted for through the conceptual framework of the theory. This point will be dealt with in more depth in the analytical section. Lastly, it should also be mentioned that even though changes to national democracy of the introduction of fiscal federalism will also be analysed, theoretical accounts of this are less vital. Here the effects on national democracy will primarily pertain to the inclusion of matters under public control that have been lost in the national sphere, and since this belongs exclusively to the first, formal side of democracy, it can be more straightforwardly measured and accounted for. The counterargument could be made that since the EU itself suffers from a democratic deficit including matters under EU control would in fact not boost democracy. This is, however, more a matter of EU than national democracy, and will therefore be dealt with when analysing the democratic deficit through the theoretical prism devised here.

Chapter 4: The congruence method step 1

The economic situation in the EU

In line with what was outlined in the methodology section, the analysis of the democratic effects of federalising some aspects of fiscal policy will now be assessed through the three steps of the congruence method. A starting point for assessing the effects of the posited reform, and thus the first step of the congruence method, is to be clear about what the context looks like in which the reform is introduced. An empirical analysis of what powers the EU has, how they are organised, and how they have worked in practise is therefore needed. EU competences are, however, multifaceted, since they can be either exclusive or shared, and they can also require decisions to be taken by unanimity or qualified majority voting (QMV) in the council, and be with or without parliamentary co-decision (TFEU Art. 3 ; TEU Art. 14 ; 16). This means that there is important variation between powers granted to the EU. As mentioned earlier the EU has its main economic powers in general economic regulation, primarily as part of the single market programme, and in monetary policy for the EMU member states. The four freedoms providing for the free movement of persons, goods, capital, and for the freedom to provide services, constitute the core of this, since they have authorised the EU to initiate legislation that combats technical, physical, or economic barriers in the member states to these freedoms (McCann 2010: 30). This culminated in the single market programme under the Single European Act, where many remaining barriers, especially for capital, were removed. These trends were further reinforced by Cassis de Dijon and other ECJ judgements where mutual recognition of national standards for goods, qualifications, or for setting up companies were laid down, meaning that if a good or practise was allowed in one member state, it should also be so in the others (Hix 2005: 124).

These development have led, e.g. to that a state can no longer offer (discriminatory) support to national corporations, that previously existing national monopolies had to be opened up, that a company wanting to do business in Denmark can set up in England with the exclusive motivation of circumventing the stricter Danish regulations, and a general inability of states to retain policies or regulations that threaten a coherent European market (Craig & de Burca 2008: 809). The member states do, however, still have substantial influence through their role in the Council, and the economic powers are also shared rather than exclusive, except for when competition policy is in question (TFEU Art: 3). The member states have also retained some authority through the fact that the goal of European economic coherence has generally,

but not always, been pursued through harmonisation of national standards rather than through the creation of new, genuinely European standards (Hodson & Maher 2002: 395). This leaves some formal decision-making capacity with the member states, but it is difficult for Denmark to insist on its tough criteria for setting up businesses when European integration has rendered it far easier to circumvent them, leading to a national capability loss. The general point stressed earlier should also be reiterated here, that national competences have been hollowed out in certain respects not only through the process of European integration, but also through more overarching trends of economic globalisation. These developments have led to that some economic powers have not only been exalted from the national level, but in fact disappeared completely from the formal European political sphere (McKay 2002: 94).

So even though the member states have retained some important power it is still clear that the EU has substantial influence both directly and indirectly over national economic policy, but its powers are even more far reaching in the EMU. Here the EU has exclusive powers, and the executive board of the European Central Bank (ECB) consists of entirely supranational actors (Bladen-Hovell 2007: 258). The politically independent ECB is responsible for setting interest rates and regulating the money supply for the entire Euro area, with the key goal of ensuring price stability through low inflation (TFEU Art. 119). These are central economic competences, and were previously frequently used by the member states e.g. to influence economic cycles, but are now included in the only EU competence where the elected representatives of the member states are completely excluded from the decision-making process. Given that there is a close affinity between fiscal and monetary powers and that they directly influence each other, the creation of a monetary union had to be complemented by the laying down of certain fiscal rules and boundaries within which the member states can pursue their own fiscal goals (Morris et al 2007: 288). The use of fiscal policy of one EMU member affects the monetary situation of the union as a whole, and since the member states cannot directly influence the fiscal choices of others, it became more important to have a framework of guidelines ensuring overall fiscal coherence. The EU's greatest current fiscal powers thus lie here in setting criteria for extents of national fiscal spending, rather than in spending or collecting revenue on its own.

Some more substantive EU fiscal policies do, however, exist, notably in the area of indirect taxation and in spending, mostly through the Common Agricultural Policy and the Structural Funds. The EU has powers over indirect taxation e.g. in terms of harmonising VAT by laying down a minimum tax rate of 15% in the EU (McKay 2002: 85). It can also use its funds to correct for market imbalances through its two largest budget posts, the CAP and structural funds, which at face value seems to show that the EU in fact has some important fiscal competences. However, the EU budget is only 1.045% of the total GDP of the member states, which means that any spending based fiscal policy undertaken by the union is bound to have limited effect (Falkner 2007: 279). Moreover, any support through the structural funds to poorer regions is project specific, and must be complemented by national level support, which also serves to limit its redistributive effects. And most importantly, many of the core features of fiscal federalism, such as direct taxation, generalised redistribution, or stabilisation at times of asymmetric shocks, are completely excluded from the union's competences. The union's own fiscal competences are therefore either weak, at best, or non-existent, at worst, which means that negative integration and harmonisation have been pursued to ensure some degree of fiscal coherence.

Most of the harmonising fiscal provisions are included in the Stability and Growth Pact (SGP), which was introduced in the early 90s to prepare for the introduction of the common currency and for the final abandonment of national monetary policies. Although introduced as part of the EMU the main regulations actually apply to all EU members, even though some of the more detailed provisions require more of EMU members (Rotte 2004: 54). Two salient provisions in the SGP are that the member states should have an annual budget deficit that is lower than 3% of GDP and a total national debt smaller than 60% of GDP, except when exceptional circumstances render temporary deviations necessary (Morris et al 2007: 300). Inflation levels should also be kept within 1.5 percentage points of the three best performing states (Snoddan 2005: 177) Problematically, however, the empirical record of EMU so far indicates that the set-up has been ineffective in ensuring the obtainment of these goals. In the years leading up to stage three of EMU the members-to-be reduced both deficits and debts because the carrot of membership served to inspire fiscal prudence, but after membership the situation either stalled or worsened (Morris et al 2007: 303). Since 1999 EMU members have not adhered more strictly to the provisions of the SGP than non-EMU EU members, leading to a perpetual incongruence between fiscal and monetary policy in the EMU.

The lack of supranational fiscal capacity in the EU has therefore lead to that what can be termed an “effect-capability” gap has arisen, since the member states’ constrained ability to influence the fiscal behaviour of others through formal political procedures, is out of sync with the consequences experienced by their decisions. The effects of European economic integration are thus far greater than the political ability of a given member state to manage these effects, which consequently further hollows out national political competences (Agné 2011: 269). This context of extensive economic powers, exclusive monetary powers, and fundamentally constrained fiscal powers, is thus what fiscal federalism would be introduced into. Such far-reaching policy incongruence differentiates the EU from other polities, and it is worth investigating whether fiscal federalism could alleviate this incongruence and thus present more realistic political choices for a European demos to decide democratically over.

The democratic situation

The union’s current democratic conditions have already been outlined, but more detail and more concrete measurements are needed as a basis for the congruence method. The formal institutional make-up will first be dealt with, and on the face of it the EU passes many of the tests devised for assessing whether democracy is present (Knutsen 2010: 110). The EU holds regular competitive elections and important democratic rights and principles are guaranteed. Still, certain aspects of the institutional power balance in the EU, as well as the ties between the EU and the member states, serve to undermine the standing of the EU as a democratic actor in its own right. Firstly, the strengthening of executive actors is inherent in the set-up of the EU. This is shown in that national ministers get a legislative capacity in the Council not available on the national level, that national parliaments are by-passed, that the main actors in the Commission are also appointed by national governments, and that few EU level control mechanisms exist (McCormick 2008: 172). Executive dominance thus arises both out of the empowerment of national executive actors and through the disproportionate power of executive bodies in the EU institutional machinery (Weiler et al 1996: 8).

Still, some ameliorating developments have taken place over the last decades. The EP has been gradually strengthened, leading to that even when national parliamentary actors are circumvented, European level actors can assume some of the balancing functions (Hix 2005: 176). Also, the inclusion of national parliaments in the legislative process, including the ability to cross-nationally block pieces of legislation, has at least formally restored some previously held national parliamentary powers. However, studies show that the limited

resources available to national parties lead to that they can only engage with around 10% of the draft legislation and white papers sent to them (Lord & Harris 2006: 74). A more fundamental problem is, however, that the executive of the EU is not made up of the winning parties of an election, thus hindering typical institutional balancing by making the parliament free-floating in a for democracies unusual way. This is coupled with the fact that the Council and the EP to a certain extent are akin to the two chambers of federal systems, only that in the EU the roles are reversed (Börzel & Hosli 2003: 184). The geographical representatives taken from each constituent unit are in the first chamber, and the political parties that are directly elected by the entire polity are in the weaker second chamber. This means that in the EU territorial, rather than functional or ideological, interests constitute the main lines of division. These facets of the EU institutional set-up serve to compromise its democratic standing, but will not receive further treatment here, since the situation will not be directly affected by the introduction of fiscal federalism. Indirectly the consequences can, however, be felt also for the formal democratic make-up, and these effects will be engaged with later.

As far as the democratic situation on the national level in the member states is concerned, fewer concrete scores are available. This is because many of the policy options that have been lost through economic globalisation still exist in formal terms, and the practical unfeasibility of actually using them is therefore less easily measured. The fact that national competences have been hollowed out in general has, however, been noted, especially in areas of taxation and business regulation, and reforms reintegrating such factors into the public sphere must therefore be considered democratically relevant (Stiglitz 2006: 9).

European parties and elections

The situation in the societal side of democracy in the EU has, in contrast, received more significant interest in the academic literature, which has resulted in that a number of different ways of operationalising party competition, public deliberation, and the existence of a European demos have been devised. Firstly, it has been noted that the EU does not have an independent party system, in the sense that the organisation, style, and funding of EP election campaigns are determined by national conditions (Commission 2010: 5). The lack of an independent European regulatory framework means that parties need to operate under national rules, leading to that 27 separate party systems are involved in an EP election. Moreover, the actors operating in the EP are in fact predominantly party groups rather than individual parties, and these work in a manner akin to umbrella organisation trying to

streamline the behaviour of the constituent parts. National parties run the campaigns and select the candidates, and the 170-odd national parties chosen then form the currently existing 7 EP party groups (Commission 2010: 15 ; McElroy & Benoi: 2005 6). These are thus inherently heterogeneous post-election creations whose policies stem from the relative strength of the members, which means that the policies of the eventual political groups cannot be stated explicitly beforehand. This places a fundamental constraint both on the ability of the voters to know what policies their vote will end up supporting and on the possibility of cross-national debate.

Many studies have, however, managed to use e.g. roll call data, interviews, expert opinions, or analysis of manifestos, to show that the EP party groups do differ in relevant respects, at least insofar as formal party policy is concerned (McElroy & Benoi 2005: 7). They differentiate themselves e.g. on socio-economic grounds, as well as on their commitment to European integration, but their ability to translate these differences into a structured competition where the voters have clear, demarcated choices about the future European policy agenda is still fundamentally constrained (Bartolini 2005: 345). These organisational problems are then further exacerbated by the fact that the elections are generally treated as being of "second-order" importance by voters and parties alike. European parties debating European issues could, hypothetically, emerge even without the regulatory underpinnings of a European party system, but their second-order nature serves to prevent this in practice. The general idea behind this line of thought is that voters perceive the outcome of EP elections to be of lower important to their daily lives, and they can therefore vote in a different way than they would in national elections (Hix 2005: 192). Empirically observed consequences of this are that

- turnout to EP elections is far lower (43% of eligible voters in the 2009 elections) (Eurobarometer 2009),
- incumbent government parties lose votes compared to the most recent national election (since voters see EP elections as a way of punishing them)
- bigger parties lose more votes, since voters, perceiving the elections to have a lower bearing on their daily life, can vote less strategically and thus choose parties closer to their preferences. The parties are, however, still closer to their preferences for *national* politics (de Vries 2011: 18).
- The timing of the EP elections in the national election cycles affects the extent of the above-listed consequences, as well as the salience assigned to them by national parties (Hix & Marsh 2007: 496).

These effects are all interesting in their own right, but for our purposes the most important lesson to learn from this is that EP elections are democratically questionable since it is primarily national factors that determine the outcome. National conditions and considerations are the key predictors of EP election results, and there are therefore few already existing genuinely European preferences among the voters that parties could capitalise on if they only organised on the European level. Such preferences would have to develop, rather than be a priori discovered, by giving people reasons to treat EP elections as important in their own right.

The "demos question" and European media coverage

The last empirical bases of European democracy that need to be dealt with concern the lack of both European media coverage and of a European demos. A demos is, essentially, a group of people that are homogenous enough to engage in structured debate in order to decide upon their common political future. There are significant differences in degrees of coherence between national demoi as well, for example between Finland and Switzerland, but there are both subjective and objective factors hindering the development of a demos at the EU level to a greater extent than what can be witnessed in national settings.

Firstly, the European citizenry lacks the cultural, lingual and ethnic homogeneity usually required for a shared identity (Schmidt 2006: 17). Having such factors in common usually creates a type of framework around which people can converge and it can also serve to create lines of demarcation between insiders and outsiders. And secondly, although many Europeans feel an affinity to some type of shared, but ultimately diffuse, Greco-Roman and Judeo-Christian heritage, a thick sense of subjective identity leading to a sense of shared destiny also seems to be underdeveloped in the EU compared to on a national level (Weiler et al 1996: 11). This is directly tied to democracy in the sense that without the communicative tools, shared symbols, language, etc. of a demos, no democratic deliberation over the policy agenda can take place. If the Greeks and the Germans do not consider themselves politically and ideationally connected, they have little reason to engage in ideological debate and the political decisions will thus lack the valuable legitimacy that comes from popular inclusion in the process.

The lack of debate arising from the underdeveloped European demos is further exacerbated by the relative weakness of trans-European media. Media are important in ensuring that people discuss the same issues at the same time and have similar frames of references, since the informational underpinnings of structured discussion will otherwise be absent. The communication science literature has suggested that media is the most important link between politicians and voters, and 2/3s of EU citizens report seeing media as their most important source of political information (Peter & de Vreese 2004: 3). In regards to the EU media studies have looked e.g. at how much attention the EU receives, what kind of attention it receives and how it is framed, and at whether non-EU issues are discussed coincidentally in Europe (Risse & van de Steeg 2003: 3). The studies have found firstly that there is a lack of ongoing coverage of decisions made and events transpired in the EU, and that it makes up 5% of the political news on average in the member states (Peter and de Vreese 2004: 5). This scarcity in coverage is then coupled with a tendency to portray the matters that are covered from a predominantly national perspective where national, rather than EU, officials are in the foreground. This means that EU political developments tend to be depicted through their ideological fit with predominant national conceptions, and the EU actors responsible for them usually remain relatively anonymous.

Thirdly, as far as non-EU political news or debates are concerned, conspicuous differences between the member states have been found in regards to what the salient political topics are at a given moment. Although some studies have been found an EU news sphere to be nascent (Risse & van de Steeg 2003), in general it seems as if European media are poorly equipped to structure cross-European debate. Peter and de Vreese conclude in their study that the main reason why the EU lacks news value is because a key element is missing – conflict (2004: 7). Since neither political parties nor the institutions debate along clear ideological lines it is less interesting as news. A multiplicity of facets of the democratic deficit thus stem from the same underlying issue, namely that structured political contestation and the accompanying public deliberation are missing. It is, however, important to be aware of the individual problems, since it is by measuring the effects on these that the democratic consequences of the introduction of fiscal federalism can be understood.

Chapter 5: The congruence method step 2

Designing the fiscal variable

In line with critical realist research strategy, the present purpose is to select a mechanism that will be introduced in the above described context. Given that the goal is to assess whether fiscal federalism has the potential to elicit changes that can aid the union by ameliorating the democratic deficit, the fiscal competences assigned to the union must operate in the manner most conducive to European democracy. An investigation into the workings of fiscal federalism in current federations is thus first undertaken, and the insights garnered here, as well as considerations stemming from the democratic theory adopted, will then feed into the design of the union's fiscal competences. A comparative analysis of the workings of fiscal federalism in established federations reveals that salient differences are present in regards to how centralised policies are, how they operate, and what their consequences have been. Since previous sections have shown that the two main problems facing the union are that the political and economic spheres are out of sync and that there is a lack of structured competition between demarcated political parties, changes brought about by fiscal federalism that can counteract these problems will be in focus. The analysis will rely both on general insights from the field of fiscal federalism, as well as on more in-depth studies that have been carried out of Canada, Australia, and Switzerland (Snoddan 2004 ; Patchey & Wells 2004 ; Schaltegger & Frey 2004). Fiscal federalism varies greatly in these three countries, which opens up for an interesting comparison to be made, since by looking at their common ground a set of shared policy goals and tools become discernible.

The main lines of demarcation between fiscal federalism in established federations do not arise out of ideology, but rather out of the vertical divisions of fiscal power. Some federations, such as Switzerland and the US have highly decentralised fiscal policies, where the states can collect much of their needed revenue, incur debts, decide on welfare policies, etc. (McKay 2002: 88). In Canada, Australia, and others, in contrast, most of the tax revenue is collected by the central government and then distributed to the states, so that the states are still responsible for the design and provision of public services (Snoddan 2004: 187). The idea in these federations is that the central government has a comparative advantage in collecting revenue, whereas the constituent units are better at catering to local preferences by providing regionally tailored public goods, which thus can serve to combine the advantages of littleness and magnitude in fiscal policy (Oates 2004: 14). There are also noticeable differences between centralised and decentralised federations in regards to what kind of

revenues (e.g. income tax, corporate tax, value added tax) are collected exclusively at the federal levels, and in regards to how they are transferred to the constituent units (e.g. via one-off payments, regular intergovernmental transfers, transfers to individuals, etc). The federations also display significant variety in regards to how extensive interstate inequality is tolerated (Patchey & Wells 2004: 137). Centralised federations such as Australia and Austria have displayed a greater commitment to inter-state equity and have therefore set up more comprehensive systems of automatic fiscal stabilisation and redistribution.

The core fiscal set-up

Despite these differences in regards to collection and distribution, however, there are certain overarching fiscal goals that all federal governments have the aspiration, and policy means, to pursue. This is firstly the right to redistribute funds in order to combat asymmetric shocks and to ensure overarching macroeconomic stability. Federal governments thus have both stabilisation mechanisms at their disposal to combat temporary fluctuations and instability, and more long-term redistributive measures aimed at structural horizontal fiscal imbalances (Snoddan 2004: 176). There are also jointly agreed upon criteria for when a state is qualified for federal funds (e.g. when its GDP drops at a certain pace or when it has a particular level of unemployment) as well as a shared institutional web that can lay down fiscal guidelines and supervise implementation measures (Hansson 2011: 185). This inclusion of the fiscal behaviour of the constituent units under into the formal democratic processes should be seen in stark contrast to the ad hoc, post facto EU way of allocating emergency funds to troubled member states. Another common feature is that even though income and corporate taxes go from being completely centralised (e.g. in Australia) to being primarily a state-level concern (e.g. in Switzerland) some taxes, primarily those on highly mobile units and those that are progressive, tend to be central in order to avoid unhealthy tax competition (Schaltegger & Frey 2004: 156 ; Vrousalis 2005: 184). Lastly, currently existing federations have made sure to use fiscal and monetary tools in a complementary fashion. Studies have shown that incongruence between the two can lead to inflation, output losses, or simply policy inefficiency, and federations have therefore generally favoured a centralisation of those fiscal competences needed to complement monetary policy (Morris et al 2007: 291).

Designing the union's fiscal framework

So their fundamental differences notwithstanding, fiscal federalism in established federations is characterised by a few shared institutional features and some core policy goals are obtained using it. These observations therefore indicate that even the more decentralised federations have a central fiscal framework extensive enough to obtain the main politico-economic gains that can be derived from fiscal magnitude. There are a number of reasons why such a modest version of fiscal federalism would be a more prudent starting point for the EU. Firstly, a basic fiscal framework has the advantage of being streamlined which would make it easier to agree to for the 27 member states than the more developed and specific kinds. Secondly, a more decentralised fiscal structure would respect the principle of subsidiarity innate in the union's set up by leaving power over matters that can be carried out locally at the state level. And thirdly, opinion polls and surveys have shown that the European public is not prepared to cede more extensive fiscal functions at present (Berg 2011: 125) The suggestions for the EU are thus to introduce standardised and centrally managed stabilisation and redistribution, allocate the current cohesion policy a higher percentage of the European GDP, grant the EU powers to tax highly mobile units and consumption, and to introduce supranational decision-making and supervisory procedures that can make fiscal policy part of the democratic machinery. Such a set-up would be economically advantageous for the union in many respects by moving policies to a level where they are more effective and efficient, but would also include many currently tacit or indirect EU powers into the formal democratic machinery (Oates 2004: 14).

It could also improve compliance with the SGP, since even though debts and deficits could still be incurred nationally, EU measures for stabilisation and redistribution would render deviation from the regulations less necessary. National leaders who now fear that actual compliance with the fiscal strictness required by the SGP would involve the removal of politically popular spending programmes, would feel more secure in compliance if they had an EU fiscal safety net to fall back on (Vrousalis 2005: 185). The experiences of other federations also show that there are both formal and informal democratic gains to be made from centralising some aspects of fiscal policy, and whether this makes up for the negative consequences that can ensue from a further loss of national competences will be analysed in the final section. For now suffice to note that centralisation, as opposed to harmonisation, is a prerequisite for obtaining many of the positive effects on democracy, and that many of the effects observed in established federations can be derived even from the slimmed-down fiscal

framework proposed here. Granting the EU such a core set of fiscal competences would still allow for democratic deliberation over EU tax rates, rules and implementation of fiscal redistribution, the size of the extended cohesion funds, etc. It would consequently open up for democratic processes that are institutionally prevented both in the current system and in a stronger system of fiscal harmonisation (Agné 2011: 269).

It does, however, also need to be mentioned that it is not enough to simply grant these powers to the general EU machinery, since the relative power division between the institutions in this matter directly affects the democratic outcome. Or, to be more precise, the formal democratic advantages of ensuring greater coherence between the political and economic sphere would be garnered irrespectively of the institutional power balance, but the positive effects for party competition and public deliberation could not be achieved unless the parliament was granted a right of co-decision. Tempting though it would undoubtedly be for state leaders to keep such a sensitive policy area under intergovernmental control by making it an exclusive competence of the Council, if the parliament were not granted the right to co-decide political parties would have little reason to develop a stronger European policy focus. EP electoral campaigns would thus not be driven by European issues any more than they are today and genuinely European parties would not have any greater reason to emerge. And since the Council is more inaccessible to the public and thus lends itself less well to public deliberation, genuinely cross-European communication would not receive any impetus from this.

The empirical lessons learned from existing types of fiscal federalism as well as general concerns stemming from the theory of democracy adopted here, therefore propel us to suggest a particular type of fiscal strengthening in the EU. Only the core competences needed to ensure effective macroeconomic stabilisation and political control over key economic forces should be ceded, and a particular type of institutional power balance is needed to reap the democratic benefits. Both vertical divisions of functional competences as well as the relative power of the actors in the horizontal institutional web therefore matter, and have figured into the design of the EU type of fiscal federalism whose democratic consequences will be assessed.

Chapter 6: The congruence method step 3

Analysing the effects

The empirical and theoretical scenes have now been set to the degree necessary for an analysis of how the causal mechanisms of fiscal federalism ought to work in the EU to be undertaken. The main problems inherent in this endeavour are to assign certainty to effects only foreshadowed and to account for other contextual factors that have hindered or reinforced the effects of fiscal federalism on party competition in the established federations. That is why commonalities in outcome in federations of different degrees of centralisation and with different social structures will be searched for and coupled with stringent theoretical reasoning in order to provide an explanation for the causal chain. Conclusions for the formal, institutional democratic situation can, however, be more safely drawn, since these effects do no stem from an ongoing societal process with trends and countertrends, but arise directly in the moment in which the powers are transferred. The changes are therefore innate features of the analytical presupposition, and the empirical transformation should therefore be more uncontentiously visible.

This leads to the general claim repeatedly stated earlier that granting the EU the fiscal competences described in the previous section would bring certain, currently largely independent, economic forces under formal political control again and that a net democratic gain would arise as a result. The empirical justification for this has been outlined earlier, and now two plausible counterarguments must be dealt with, namely that further centralisation would undermine national political power to a degree that renders the change democratically unjustified, and that the EU's questionable democratic credentials would prevent European democracy from actually benefiting from the reform. The first counterargument can perhaps be more straightforwardly countered, since part of the empirical justification for the suggested fiscal change, is that nation states have lost relevant power in the area already (Stiglitz 2006: 9). Granting the EU such fiscal competences would therefore not circumscribe national powers as much as it would create the potential for a wielding of formal power no longer practically held by national public actors. Legally some fiscal authority would have to be ceded, but since studies have pointed to that much of it cannot be utilised in actuality by national governments, a net gain of public control is bound to arise from the proposed reform (Vrousalis 2005: 191). For this reason, and because of the increased European coherence that would ensue, efficiency and effectiveness in fiscal policy-making would also increase, and

national electorates could thus pursue fiscal outcomes that they at present cannot hope to achieve.

The latter counterargument is more troublesome, in that it suggests that even if there is a net gain in public control, this would suffer from the general democratic deficit facing the EU, and imperfect, but genuinely democratic, national competences might therefore be preferable. This argument can be countered firstly with the contention that it follows from the argumentation above that far more competences would be gained by the public sphere than lost. So it is not merely a matter of national powers currently being there but being suboptimal, but instead that fundamentally new powers would arise. The question is therefore not whether constrained national powers are preferable to democratically deficient EU powers, but whether EU powers are preferable to the economic forces in question being subject only to the logic of the market and to ad hoc decisions of incongruently acting individual states. The EU member states cannot unilaterally introduce new taxes on corporations or high income earners because of the exodus it would induce, they cannot bring monetary and fiscal policy in line because they cannot directly interfere with the fiscal situation in other member states, and countries facing economic problems can only wield delimited fiscal tools to ameliorate their situation and cannot democratically shape the terms of their bail outs (Agné 2011: 269). The real question is thus whether the EU is so democratically deficient that these wide-ranging shortcomings in public control are preferable.

As the overview of the EU's democratic credential showed, however, EU democracy is in lack of certain salient elements rather than completely non-existent. The legislative actors in the EU are either directly or indirectly elected which at least theoretically creates opportunities for public control, the EU guarantees through its treaties and charters on human rights the prerogatives and formal social conditions that underpin democratic societies, and measures to ensure accountability and transparency are built into the procedural framework (Hix 2005: 176). This set up would allow the EU to receive a pass in most of the standard tests and indexes of democracy. The lack of structured party competition and of a deliberating European demos renders EU democracy inferior to that of the member states, and especially to that of the democratic ideal outlined in the theory of participatory democracy, but EU governance is still democratic on many scores. The conclusions stemming from this deductive chain must therefore be firstly that the suggested fiscal reforms would enhance the scope of public control and secondly that this public control would be democratic on many

scores, which means that a formal democratic gain would be obtained. In practice, then, both of the counterarguments that have been offered against the proposed fiscal reform are found to miss the theoretical mark, and an immediate effect of legally exalting the base of some facets of fiscal policy in Europe would thus be to improve the formal, institutional democratic situation.

Fiscal policy and party competition in established federations

The analytical desire to assess the innate causal connections between fiscal policy and party competition means that a number of different scores depicting their relationship are needed. A first indicator is the overt correlation between degrees of fiscal centralisation and the nature and extent of party competition in established federations. A second would be the general lines of demarcation between political parties and especially how they choose to frame their differences. If fiscal matters generally constitute key points of contention between parties and if they receive much attention in party manifestos and electoral campaigns, then the existence of a general link can be posited. Lastly, statistical surveys of electoral behaviour and the salience attached to different issues by voters could shed light on the role of fiscal policy in inspiring the public deliberation that underpins democracy and that political parties feed off of. These empirical attempts at uncovering the causal mechanisms at play are then coupled with a theoretical exposition of why this has taken place in order to comprehend the process of causality.

A host of empirical studies have found that there generally is a strong correlation between degrees of fiscal centralisation in a federal state and the national coherence of party competition. Thorlakson uses data from IMF financial analyses as well as constitutional analyses to measure the extent to which revenues and expenditure are dealt with by the federal government, and finds that the greater the degree of centralisation on these scores, the more likely it is that federal and state parties are integrated (Thorlakson 2007: 70). By looking at three different scores, namely how nationally uniform a party's electoral support is, how nationally consistent its electoral swing is (i.e. whether changes in party support are similar manner across the nation) and how coherent party structure is, Thorlakson uncovers a picture that over time is fairly stable. The more centralised the fiscal system (e.g. in Germany, Austria, Australia) the more homogenous are the patterns of party support, whereas the more decentralised federations (the US, Switzerland, Canada) have the most incongruent party systems (Thorlakson 2009: 165). This means that in the US, Switzerland, and Canada the

debates and points of contention are more geographically determined, since the matters discussed by parties and voters change to a far greater degree from state to state. It is therefore more likely either that local parties emerge that are strong only in specific states or that the central, federal parties become more like umbrella organisations that are comprised of highly varied regional parties (Chandler & Chandler 1987: 93). Both of these trends serve to hinder genuinely national political discourse, since the parties are not coherent enough to launch structured national debates and the questions publicly deliberated upon are thus not shared by the entire polity.

The theoretical explanation for this observation is perhaps rather common-sensical, in that if taxes are to a high degree decided by the regional government, and if public services, such as health care, education, and infrastructure, are also designed and implemented by regional actors, than the electorate has strong incentives to prioritise these elections. If these salient governmental functions are regionally determined then they are likely to differ from state to state, and either regionally distinct parties are thus likely to emerge or greater variety in federal parties must be allowed for. The ability of regional governments to respond to the needs of their distinct electorates is a key feature of the federal set-up, but the greater the pressure for regional distinctiveness, the more party cohesion will be undermined (Chandler & Chandler 1987: 89). The negative consequences for democracy arising from this polity fragmentation will then have to be measured against the advantages of local access to the key governmental functions and the increased participation it might lead to. The degree to which parties are centralised is, however, tied to other matters as well, such as the rules of the party system (since this places organisational financial constraints on the parties) and other political matters such as defence and foreign policy (Commission 2010: 5). Fiscal policy is thus not the sole creator of the nature of party competition, but it is nonetheless clear that there are both empirical and theoretical reasons to support the view that fiscal policy is causally connected to party coherence, a connection which then can be hindered or reinforced by other features of the socio-political context.

Territorial considerations

A second way to assess the posited relationship between fiscal policy and party competition is to look not merely at how party cohesion is affected by varying degrees of fiscal policy, but also to look more explicitly at the contents of the discussion political discussion and questions prioritised in national elections. In federations there are usually both subjective and

objective factors for regionally distinct demoi to emerge, which means that it is easier for parties to feed off of geographical, rather than ideological, differences (Chandler & Chandler 1987: 95). It is problematic for democracy when the political discussion is more concerned with territorial than functional matters, since people cannot deliberate on their geographical belonging in the same way that they can debate how the state should collect revenue or provide public goods. When political parties claim to be representing a particular region or people (e.g. the Quebeqois) then equal and inclusive cross-polity deliberation is institutionally prevented, and the educational process through which the citizens come to hold more well-founded views can therefore not take place (Barber 1984: 19). In a similar vein to what was argued above, there are theoretical reasons to believe that territorial lines of division are more common in places where fiscal federalism is less developed. This is firstly because if fiscal policy is more decentralised and national elections thus less able to influence the core political matters of public revenues and expenditure, then other matters that can ensure votes become more prevalent. If matters of function and ideology are not decided upon by the central government, then other differences must be seized upon by the parties participating in federal election to separate themselves from their competitors and to attract voters. Geographical matters thus become more important.

A second theoretical reason is that centralised fiscal competition has the potential not merely to encourage rational deliberation and cohesive party organisation, but also to influence people's subjective identity. A number of scholars have pointed out that people's identities are not natural and static, but instead perpetually created and thus malleable (Schmidt 2006: 18). A shared identity must thus not precede public deliberation on ideological political matters, but can instead be the outcome of it, and fiscal policy could have a central role in inspiring the development of a polity wide demos (Barber 1984: 155). Since the lack of a shared demos significantly enhances the ability to utilise territorial lines of demarcation in political competition these two matters must be seen as interconnected. An empirical analysis of this does in fact seem to indicate that a shared identity can arise out of the creation of a common polity, a phenomenon which has been observed in federations and centralised nation states alike (Weiler et al 1996: 17). Establishing a centralised political system served to exalt subjective identities from the village or region to the country by creating the feeling that the citizens all have a share in a joint future. Mental lines of separation are by no means eradicated, but studies show that federations with more centralised fiscal policy also have a more coherent national demos (Thorlakson 2007: 71).

Empirical indicators do, however, point to that fiscal policy is not merely tied to the subjective identities held by the citizenry, but also to the contents of the political discussion. In e.g. Canada and Switzerland parties representing a particular region or socio-lingual group are stronger and more prevalent, whereas fiscally centralised federations such as Austria and Australia have a political discourse primarily concerned with functional and ideological matters (Patchey & Wells 2004: 147; Hadley et al 1989: 87). Geographical differences thus become more politically potent the more decentralised fiscal policy is, but just like with party coherence, there are other intervening or coexisting variables that must be considered as well. In polities with a shared history, a common language, cultural homogeneity, etc., it is more difficult for parties to identify sub-demoi to represent, and such factors must therefore be considered as well (Schmidt 2006: 17). Still, both the empirical record and deductive reasoning point to that fiscal policy holds the causal potential to bring about more policy-centred, cohesive political discourse, and this potential can be tapped into even if other variables serve to hinder the attainment of the full scope of positive democratic effects.

Individual-level indicators

Lastly, analyses of voter behaviour and other surveys of the salience citizens attach to political questions, show that fiscal matters, e.g. taxation, the role of the state on the market, the provision of public goods, etc., are consistently found to be key determinants of the political choices and preferences of the citizens (Gustavsson 2011: 32 ; Berg 2011: 125). A theoretical explanation of this is superfluous since it is not a matter of determining the causal relationship between two social phenomena. Instead the displayed subjective preferences can be taken at face value to show that fiscal policy is consistently prioritised by voters. This reinforces the point that fiscal policy inspires public deliberation, and also shows why political parties keen on gaining popular support should focus on these issues (Dahlberg 2011: 197). This again points to that fiscal policy ought to be intimately bound up with the extent and nature of party competition in the polity. Even though some of the aspects of fiscal policy prioritised by voters would not be included in the fiscal competences posited here, a number of important features of it would, and the current set-up would thus be extended in relevant ways. Such a change could consequently encourage European voters to grant greater significance to EP elections and facilitate new degrees of public deliberation.

The effects on European party competition

The various causal properties held by fiscal policy explored in the last section could potentially ameliorate the societal side of the union's democratic deficit, but the precise way in which it will do so is tied to other contextual features of the EU setting. The outcome ensuing will thus be a result of the interplay between the causal potential of the introduced mechanism and existing features of the European environment, and in this section the way that existing contextual factors would reinforce and hinder the effects of fiscal federalism will be assessed. Firstly then, in regards to party coherence, the EU does not merely lack centralised fiscal competences, but also many of the other competences and institutional features associated with party cohesion that were outlined above. It has not only regional differences in rules for party organisation, but in fact 27 separate systems, and many core policy areas that can inspire political organisation and coherence are either not part of the parliament's portfolio or absent from the EU's competence catalogue altogether (Commission 2010: 4). This indicates that a number of other variables in addition to the lack of fiscal policy can hinder the development of unified mode of party competition.

This means that the introduction of fiscal federalism, especially of the decentralised kind posited here, would not all yield all the beneficial democratic effects that have been witnessed in established federations, but some gains could still be made. The fact that the EU party system is currently comprised of loose party groups rather than of distinct and coherent parties, means that the EU has a very low degree of party structure as a starting point and the scope for improvement is therefore substantial. Even though the institutional design of the European party system serves to hinder party cohesion, fiscal federalism could still have an integratory impact, since its displayed causal ability to create more coherent party structures and to ensure that political campaigns are more standardised throughout the polity could ensure that the system is more adequately utilised. The combined effect would be held back, but not neutralised, by the other contextual features, since the suggested reforms are far-reaching enough to ensure that the causal potential observed is tapped into. The political relevance of redistribution, public investment, and taxes would in the EU, just like in federations, encourage parties to develop standardised, cross-polity positions, which means that an independent European level of political contestation could emerge and the EU could thus become democratically relevant in its own right.

Geographical competition and the European demos

Secondly, as far as territorial lines of demarcation are concerned, the EU could potentially gain substantially from the posited reform, since this problem is more acute in the EU than in even the most internally divided federations. The separate demoi have more distinct identities in the EU and at present these differences are continuously recreated by the distinct socio-political systems of the member states (Schmidt 2006: 18). Moreover, territorial interests are more strongly represented in the EU both directly through the Council and the European Council, and indirectly through the fact that the parties are generally elected as national representatives on national grounds. The previously shown causal ability of fiscal federalism to contribute to ideological and functional rather than territorial lines of separation between parties could therefore be of particular significance here. Fiscal federalism in the EU would, just like in the established federations, give parties a greater reason to campaign on substantial policy questions since politically salient fiscal matters would now be decided directly at the EU level. Since voter preferences on this matter are more tied to ideology than to their geographical belonging party competition would have reason to extend across the entire polity and thus be more genuinely European. The shown ability of ideological party competition to contribute to a stronger shared identity would therefore also be tapped into which could help bring about a more coherent European demos.

This effect could serve to take the EU towards the criteria for democracy laid down earlier, where it was stated that the EU can only be considered genuinely democratic if the voters have a shared choice between competing visions for a common European future. When territorial boundaries are more important than ideology structured political visions cannot be debated across the polity, and the “ideologisation” of politics stemming from fiscal federalism would thus boost European democracy. Some of these effects could be counteracted by the fact that the member states continue to build national demoi as well, thus hindering the development of a shared identity, and that there can be regionally distinct interests in some of the fiscal matters. Taxes and stabilisation are primarily ideological matters that should hold cross-European appeal, but general redistribution and a strengthening of cohesion policy will make certain member states net contributors and others net recipients. Although the net contributors would also benefit from the economic and democratic corollaries outlined above, it is possible that these contributory differences can be capitalised upon by parties on geographical grounds which consequently would limit the ideologisation of EU party competition. These counter-effects should be taken seriously, but

still appear to be weaker on the whole than the causal chain leading towards more functional competition in EU politics.

Individual-level factors and the media

Thirdly, the relevance attached to fiscal policies by most citizens should inspire more participation in EU elections and thus create an incentive for political parties to treat them as valuable in their own right and not merely as second order national contests. Increased popular participation in EP elections is thus likely to ensue, possibly increasing the 43% participation rate to more acceptable levels, but a strong counteracting force is also present. Most studies indicate that people are more active the more local the decision-making processes are, and ceding fiscal policy would undoubtedly make some matters more physically and mentally removed from the citizens, which could undermine national democratic processes (Oates 2004: 30). Moreover, the fact that subjective identities are still divided and that coherent party competition is still underdeveloped means that increases in public participation at the EU level stemming from the posited reform are likely to be off to a slow start. The causal potential is, however, there, and this should thus be seen as a gradually progressing process where public participation is likely to grow in accordance with the developmental pace of the other changes set to ensue. EU level public participation might not increase directly after the legal change has been undertaken, but will slowly come under way as parties become more coherent and their political discourse becomes increasingly ideological. And given that most features of the suggested reform will bring new matters under public control rather than further hollow out the national sphere, fears over a potentially negative impact on domestic political activity are likely to be exaggerated.

A number of important effects with indirect relevance for European democracy could also be garnered. Media studies have shown that the existence of conflict is essential in ensuring the news value of a particular event. Greater party coherence and thus more structured EU political debate could consequently contribute to that the paucity of media attention devoted to EU matters is counteracted by making the lines of conflict more pronounced. This would not necessarily lead to that the same issues are discussed at the same time by a cohesive European demos, but would still ensure that the citizens have a greater supply of, and more direct access to, genuinely European political information. Again the point is therefore reinforced that many facets of the civic side of the democratic deficit are outgrowths of the same underlying dilemma, namely the absence of structured European political contestation.

Although the formal aspects of the democratic deficit, e.g. executive dominance, would not be directly affected, it seems as if with only a slight risk of oversimplifying we can say that the introduction of fiscal federalism would serve to ameliorate the lion's share of the civic side of the deficit. Its displayed ability of bringing about coherent, ideological party competition goes to heart of the democratic challenges facing the EU, and could therefore be an important next step in the modernisation of the union.

All in all, then, the gradual built up of the congruence method in the last two sections and the analytical work carried out here have identified the effects of fiscal federalism as inherently related to many of the democratic shortcomings facing the EU. Some features of the union's democratic deficit would be unaltered by the proposed change and others would only be indirectly affected, but the causal capacity of fiscal federalism as uncovered in studies of existing federations would still go a long way towards alleviating some of the EU's main problems. The fiscal competences proposed here for the union would contribute to the establishment of a more coherent mode of European party operation, a more ideological, issue-based competition, and gradually also inspire citizens to participate more in European elections and to see them as significant in their own right. Even though the suggested reform is not a panacea and will not bring about the desired effects mechanically, the empirical and theoretical results still show that the granting the EU a set of core fiscal competences would go a long way towards ameliorating its democratic deficit.

Conclusion

The goal of this paper has been to investigate whether European democracy could be improved by a granting of fiscal competences to the union, and a long empirical, methodological, and theoretical road had to be walked in order to allow for meaningful conclusions to be drawn. Since the epistemology of critical realism opted for here required a clear understanding of the European democratic context as well as of the causal mechanisms associated with fiscal federalism in established federations, a strong conceptual background had to be built before the analysis of the research question could be directly engaged with. The lack of existing research on the proposed causal relationship also meant that a more comprehensive background picture had to be painted in order to set the scene for the analytical section. Methodological issues were also of particular importance here because the future nature of research topic as well as the complexity of the concepts explored here made methodological clarity and delimitations necessary. These challenges inherent in the research set-up notwithstanding, a number of results that can be both empirically and theoretically justified were yielded.

A general conclusion initially come to was that fiscal integration was economically justifiable since the ability to redistribute resources, to tax mobile units, and to stabilise markets during times of asymmetric shocks, should generally be held at the central level (Oates 2004: 18). Fiscal federalism could thus alleviate many of the problem arising from the economic and monetary integration undertaken by the union, but would also have inescapable effects on European democracy. In this paper the conclusions were drawn firstly that formal European democracy, i.e. the ability of the European peoples to utilise the institutional powers of the public sphere, would benefit from granting of fiscal competences to the EU. That is firstly because the economic integration in the union and globalisation have rendered economic forces more difficult for the individual nation state to control and thereby hollowed out some political competences. Extending fiscal decision-making capacity to the EU level would thus bring some matters back under public control, but would also give the member states a greater ability to affect both their own and each other's fiscal situation. At present the member states, especially the members of the EMU, have only limited fiscal tools to combat economic downturns, and their ability to use formal democratic procedures to affect the fiscal choices of others (whose effects are strongly felt) is minimal. Fiscal integration in the EU would thus bring matters of direct public relevance under public control, and could consequently boost European democracy by extending the scope of democratic control. Some arguments against

these reforms were engaged with, e.g. that they would move power further away from the people and that the EU suffers from too great a democratic deficit to increase genuine public control in any meaningful way, but were found not to be convincing when put under critical scrutiny.

These conclusions could be drawn with relative certainty, since they would arise directly out of the legal change suggested, namely the granting of greater, or completely new, powers in stabilisation, redistribution, and taxation to the EU. The societal side of democracy, concerned with the participation and deliberation of societal actors would, however, also be affected, and here effects were less clear cut. By using the extent and nature of party competition as a proxy for the effects on civic democracy it was found that fiscal federalism could contribute, and has done so in established federations, to more coherent party structures as well as to more issue-based, rather than territorial, competition between parties. And given the salience attached to fiscal matters by voters the EU could become more politically prioritised in its own right which could encourage greater participation and bereave EP elections of their current second order standing. These effects would, however, be less mechanical, and instead arise out of an intricate societal process with trends and counter-trends. All in all, however, the causal potential of fiscal federalism as shown in existing federations and as outlined and substantiated theoretically, should prove resilient enough to bring the EU gradually towards the posited effects. The net effect identified through the various steps of the congruence method points to a positive democratic change in both the EU and the member states, and is thus worth careful consideration.

This consideration should hopefully lead to that further research is carried out. Given that the causal connection suggested here has not received academic attention previously and that the preliminary results look promising, more research should be justified. What is needed is above all a more detailed empirical understanding of how fiscal federalism has affected the development of democracy in established federations, as well as a more in depth analysis of how the various sides of the European environment would be affected. The competences held by the EU vary, the member states tend to pursue different fiscal strategies, and the ideologising and uniting effects of fiscal federalism can vary depending on the current socio-cultural climate in the member state in question. There is thus substantial room for a more nuanced picture than what could be painted in this necessarily delimited paper and therefore

also the potential to gain a more sophisticated understanding of the effects likely to ensure from the posited reform. The conclusions reached here do indeed indicate that such an endeavour would be worthwhile, and the hope is therefore that this could contribute to a new take on some old questions plaguing the field of EU studies.

Executive summary

The workings of the European Union and the development of the global economic environment have led to that European states now face a two-fold challenge. This is firstly because the increasingly mobile nature of international capital and businesses has led to that many public economic competences can no longer be practically utilised. Since the exit option is a constantly present threat, national governments are increasingly hesitant about introducing fiscal policies, e.g. in the shape of taxation or business regulations, that could serve to inspire a mass exodus of important companies and high income earners. This limitation of democratic potential is further exacerbated by the sub-optimal democratic workings of the EU identified in the debate on the democratic deficit. In this paper the view was put forward that granting the EU fiscal competences could serve to counteract both of these problems. Making the EU more responsible for fiscal regulation and taxation could potentially both bring the economic and political competences more in line with each other, making the exit option less easy to use, and alleviate the democratic deficit by granting the EU some politically relevant powers that could inspire greater party competition and public deliberation.

Methodology

In order to assess the soundness of these presuppositions, however, extensive discussions on methodology, the EU set-up, and on theories of fiscal federalism, democracy, and the European democratic deficit were needed. Methodology was first engaged with because both the future nature of the dependent variable and the lack of similar cases make standard social science research methods difficult to use. With these considerations in mind the epistemological position of scientific realism and a research strategy based on the congruence method were chosen. Realism is an epistemology committed to using a combination of empirical data and deductive reasoning in order to uncover the process of causality. The goal is therefore to assess how the causal mechanisms in question and the context interacted to produce the observed outcome as well as to understand the constituent steps of the causal process. Understanding the causal chain was particularly important under present research conditions. This was then coupled with the congruence method, which consists of three key steps that are designed to make conclusions about hypothesised future effects more soundly based. In the first step a detailed empirical picture of the context (the workings of democracy

and fiscal policy in the EU) is painted, then the independent variable (fiscal federalism) is defined and inserted into the context, before an empirically based and theoretically stringent deductive analysis (of the effects on the dependent variable) is carried out in the final step. In the last step party competition would be used as a proxy variable for the effects on democracy, since it successfully ties together both the two main sides of democracy and of fiscal policy, as will be shown below.

Literature overview and theory

This methodological basis was the built upon by a literature overview and theoretical positioning. Here the insights in the field of fiscal federalism were first discussed, where one key argument has been that monetarily integrated actors also need a centralised redistribution scheme in order to ensure macroeconomic stability and coherence. It has also been argued that taxation of more flexible economic actors should be at the highest level, since their mobility could otherwise lead to a race to the bottom in taxation. Public goods should be provided locally in order to cater to regionally specific preferences, but taxation pertaining to mobile factors should be on the federal level in order ensure national coherence. These insights apply directly to the present research topic, since the EU member states' inability to affect their economic situation and to, in full sovereignty, choose fiscal policies, are salient parts of their current democratic challenges.

This brought us to the matter of democracy, and democracy was here understood as an essentially dual-natured concept, since both formal institutional factors and informal societal factors are needed for genuine democracy. Institutionally speaking a set of core institutions in a suitable power balance, regular and competitive elections, and a number of key rights and liberties were seen as necessary. On their own these are, however, insufficient, since these institutional conditions then need to be seized upon by an active and informed citizenry. Without the process of public deliberation where the citizenry is educated and ideas are exchanged and formed the formal institutions cannot be adequately utilised, and their democratic standing would therefore be compromised. Applied to the EU, these democratic requirements mean that a complex and multifaceted democratic deficit has been observed. Institutionally the EU set-up ensures that national executive actors are, through their role in the Council, given a type of direct legislative capacity that they do not have on the national

level, and the EU institutional power balance is strongly tilted towards executive actors. These problems are then exacerbated by the civic side of European democracy. Although the European parliament is directly elected, there are no political parties spanning the whole EU area and structured, inclusive debate can therefore not take place. European elections are also characterised by low levels of public deliberation and involvement, all of which leads to that the outcome of EP elections is primarily the result of national parties, discussing national issues, with an electorate that, if turns out at all, is primarily concerned with national questions. A European demos is also underdeveloped leading to that inclusive, Europe-wide debate is not seen as necessary by the citizenry, and there is a conspicuous lack of European media that could provide information and facilitate debate. All in all this points to the common European policy future is not determined through a structured debate about clearly demarcated political alternatives.

The empirical setting

These theoretical premises were then integrated into and built upon by the three stages of the congruence method. The first part of the congruence method sought to give a more detailed overview of the current empirical situation in the EU, in order to uncover what features of current operations would be affected by the introduction of fiscal federalism. By painting an in-depth picture of what general economic, monetary, and fiscal powers the union currently has, it was shown that many of the policy competences gradually lost on a national level and underdeveloped on an EU level would be directly affected by fiscal federalism. And by looking more closely at the nature of the democratic deficit, it became clear that many aspects of it could be linked to the lack of structured party competition. The ad hoc, nationally distinct type of party organisation, the lack of inclusive European deliberation and participation, the underdeveloped nature of a European demos and the scarcity of European media coverage could all to a certain extent be linked to the absence of competitive elections between clearly demarcated policy platforms. The question is therefore whether fiscal federalism could alleviate this situation by contributing to the development of more structured European political competition, and this would be the topic of the third step of the congruence method.

Designing the fiscal variable

In the second step, however, the exact nature of the fiscal federalism suggested for the EU had to be designed. The goal was both to ensure that the EU had the competences needed to effectively engage with the shortcomings identified in the previous section, and to simultaneously ensure that the competences were delimited enough to make them politically acceptable for the 27 member states. In light of these considerations it was decided that the EU should be granted the capacity to introduce standardised and centrally managed stabilisation and redistribution, be able to allocate the current cohesion policy a higher percentage of the European GDP, have the power to tax highly mobile units and consumption, and to introduce supranational decision-making and supervisory procedures that can make fiscal policy part of the democratic machinery. It is also important that it is included under the ordinary legislative procedure, where the parliament has co-deciding powers, since if it is an exclusive Council competence the potential benefits for party competition and European public deliberation could not be harnessed.

Assessing the effects

In the final section the in-depth analysis of the effects likely to ensue were then undertaken. The formal situation was first assessed and here it was found that some clear democratic gains could be made by bringing political competences more in line with economic reality. This would strengthen the public sphere and thus bring new socio-economic phenomena under democratic control, but some counterarguments needed to be dealt with as well. Firstly it can be argued that national democracy would be even further hollowed out by the reform, but as mentioned earlier the goal is to create new powers in order to compensate for the loss of national control rather than to cede already present national competences. Secondly, the point has been made that because of the EU's democratic deficit granting the EU new powers would in fact not serve to enhance democracy. However, given that democracy in the EU is deficient rather than nonexistent, and since the alternative would be for global economic factors and ad hoc national coordination to determine fiscal policy, European fiscal federalism in the EU was deemed democratically advantageous.

The second part of the analysis looked at party competition, and found that fiscal federalism in established federations had displayed causal abilities in many areas important to the EU.

The first trend to be empirically observed and theoretically explained was that the degree of fiscal centralisation in a federation had a direct effect on the cohesiveness of party competition. Federations with more centralised fiscal policy also had stronger and more integrated national parties leading to more effective nation-spanning electoral contestation and public deliberation. Secondly, it was found that the not only the coherence, but also the contents, of political discussion was affected by fiscal policy. More centralised federations had a political discussion more concerned with functional matters and ideology, whereas federal elections in decentralised federations were more concerned with territorial matters and the vertical division of power. Thirdly, electoral studies and opinion polls have shown that fiscal matters, such as taxation, the role of the state on the market, the provision of public goods, etc. are consistently deemed essential by voters and thus key sources of inspiration for their political involvement. All of these indicators point to that fiscal federalism has a strong causal ability to affect democracy in precisely those areas where European civic democracy is found to be deficient, namely in party competition, ideological salience, public participation and deliberation.

The last section therefore undertook a more detailed analysis of what kind of outcome the interplay between the causal mechanisms inherent in fiscal federalism and European contextual factors would lead to, and it was found that certain features of the EU set-up and social environment would hinder some of the positive democratic effects from being achieved. The EU party system is fundamentally split, the EU is built far more on territorial divisions and people are more territorially aware than in federations, and the underdeveloped demos and scarcity of media coverage can hinder the information dissemination and interaction needed for more structured political participation to develop. Still, the reform suggested is far-reaching enough to inspire more cross-European party competition and grant the EU more ideological salience, which in turn could contribute to the gradual development of the other features of civic democracy with which they have found to be interconnected. The fact that these phenomena are only nascent in the EU means that the potential for improvement is substantial even if the full attainment displayed in federations is still out of reach. The final conclusion is thus that the end result would not be a linear development, but rather an intricate and multi-faceted process. Still, the analysis of party competition has pointed to that the causal mechanisms inherent in fiscal federalism are effective in precisely

those areas where European civic democracy as at its weakest, and a net democratic gain is therefore likely to ensue.

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