

## Nontechnical Summary

The European Union is often accused of having a democratic deficit. As a remedy, it is suggested that the powers of the European Parliament should be increased at the expense of the Council of Ministers.

In the present paper, it is discussed how such a reform could help to make politicians more responsive to the preferences of the citizens. It is postulated that the decisions in the Council of Ministers are less transparent than debates in Parliament. If citizens receive bad signals about the actions of the Council, they do not know whether the politicians actually performed badly or simply had bad luck. This leads to a deterioration of Council decisions because such poorly informed voters will vote their governments out of office less often.

On the other hand, a powerful European Parliament will be less accountable to the voters in any state of the federation. The reason for this is that the majority in such a parliament will seek reelection in a Europe-wide poll. In such a poll, the incumbent majority can substitute votes won in one state for votes lost in another. Therefore, the votes in any country are only relevant if that country decides the election. Consequently, the parliamentary majority will have less incentives to take the citizens' interests into account than the governments in the Council who have to be reelected in their own state.

The tradeoff between these two deficiencies is characterised for the polar cases of policies without externalities and European public goods. In addition, the Parliament's incentives to perform international redistribution are described. Given the two countervailing effects of transparency and accountability, it is concluded that a shift of competences from the Council to the Parliament may well move political decisions farther away from what citizens want. Thus, the goal which democratisation is supposed to achieve need not necessarily be reached if the European Parliament is strengthened.

# Democratisation versus accountability - should the European Parliament be given more powers?

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## Abstract

This paper challenges the assertion that European politics would be closer to the citizens' preferences if decision power were transferred from the Council of Ministers to the European Parliament. On the one hand, citizens benefit from a greater transparency in the Parliament's debates compared to the Council's decisions. On the other hand, a powerful European Parliament would be less accountable to the voters of each state since in the European election each state is only decisive with a small probability.

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## 1 Introduction

Among the many complaints addressed at the European Union, its alleged lack of democracy takes a prominent position. A call for "democratisation" of European institutions usually means that the decision power of the European Parliament should be increased at the expense of the Commission and the Council of Ministers. It is hoped that such an institutional reform gives voters a better control of the political process, that it moves European policy closer to the people, and that it leads in the end to decisions which are more in the interest of citizens.

This is not only the opinion of the European Parliament itself, as stated in its "Resolution on the democratic deficit in the EU" (European Parliament (1988)) and in its proposal for a constitution of the EU (European Parliament (1994,

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Art. 15)). Many writers from the legal and economics professions share this view. For example, Bieber (1991) almost identifies democracy with parliamentary control. Similarly, Hauser and Müller (1995) claim that reinforced competences of the European Parliament are required at least inasmuch as the European Union extends its scope beyond ensuring the four freedoms of the Single Market. Petersmann (1995) argues in favour of a bicameral system giving the Parliament and the Council equal power in law-making. Also Dewatripont et al. (1995) propose such a reform, suggesting an extension of the fields of application of the co-decision procedure.

The purpose of the present paper is to scrutinize the alleged benefits of increasing the European Parliament's powers. As a major advantage of such a reform, I identify a greater transparency of parliamentary procedures compared to Council legislation. Since debates in the Parliament are public, and since there is an opposition which has an incentive to disclose information, people are better informed about the actions of politicians in the Parliament than in the Council (cf. Bieber (1991, pp. 403-404) and Dewatripont et al. (1995, p. 5)). This will in turn force politicians to better respect the people's will.

On the other hand, I argue that the members of the European Parliament are less accountable to the voters than the national governments represented in the Council of Ministers. Each government only remains in office if its national electorate is satisfied. The government of a member state therefore takes the national votes fully into account. Contrary to that, the ruling majority of the European Parliament seeks to win a Europe-wide election. This allows them to substitute votes won in one region for votes lost in another region. Whether the citizens of a state are satisfied only matters in the event that this nation's vote decides the European election. Hence, the incumbent majority of the European Parliament has less incentives to take into account the citizens' preferences than a national government.

This argument rests on the assumption that a member of the European Parliament votes such that her party's chances in a European election are maximised, rather than her personal share of the votes in the home district. Thus, I assume that some form of party discipline is at work. While this is clearly not the case today, it is likely to become more and more true as the European Parliament's powers are increased. The reason for this is that it will become rewarding to create European party organisations once the Parliament becomes more important. Such a party organisation will be able to offer interesting career prospects to its members, thereby creating an incentive to stick to the party line. Indeed, in all mature parliamentary democracies, the leadership of the ruling party can be more or less sure that its members follow its proposals in Parliament.

The notion of political accountability used here has been introduced by Seabright (1996) who analyses the optimal vertical assignment of powers between a central state and a collection of local jurisdictions. In the present paper, Seabright's model is applied to the European institutions arguing that the European Parlia-

ment will behave like a federal government. The tradeoff between the Council's greater accountability and the Parliament's greater transparency is made explicit. This is done for policies whose benefits are confined entirely to one member state, and to European public goods. It becomes apparent that for institutional reform in the European Union, the internalisation of spillovers is not relevant, since also the Council has to coordinate its actions. This contrasts with Seabright's approach where the core tradeoff is between the lack of accountability of the central government and the failure of local governments to correct externalities. In a later section, I also discuss which kind of international redistribution is to be expected from the European Parliament. It is shown that the lack of accountability may induce the parliamentary majority to distribute public funds in an inequitable way. This result is similar to the findings of Gupta (1998) who however follows Seabright in addressing the vertical allocation of public functions, and not European institutions.

By focussing on the assignment of decision power between European institutions, the present paper ignores a couple of issues. Thus, the vertical allocation of functions between the member states and the European Union is not questioned. Rather, it is asked which European body should decide on a function taking the European competence as exogenously given. It is also abstracted from the rôle of the Commission and from the fact that the Parliament already participates in European legislation. This is in particular true for the co-decision and assent procedures where the Parliament has a veto power (for a description of the Parliament's participation in the the legislative process, see Nugent (1994, p. 174-178)). For the cooperation procedure, the interaction of Commission, Parliament and Council has been analysed by Tsebelis (1995) and Moser (1997). Although these authors rightly emphasise that the European Parliament exerts some power by setting the agenda, such joint responsibility is neglected in the present analysis in order to point out clearly the different incentives faced by the Parliament and the Council.

Another much debated feature of European decision processes is the voting rules inside the Council. In particular, the weights of the different member states are important, both from a fairness perspective (see Bomsdorf (1992) and in particular Laruelle and Widgrén (1998)) and because of their consequence for the international redistribution induced by the European Union budget (see Homburg (1997)). However, the threshold for a qualified majority is so high that large countries have to agree to a proposal. Moreover, crucial decisions, notably the fiscal revenue system of the Union, still require unanimity. Therefore, it seems a good approximation to assume that in the Council, policy is coordinated until it is acceptable for all member governments. Complementing this literature, the present paper ignores details of the decision procedure. Instead, it is focussed upon the fundamental difference between a body elected on a European basis and one composed of politicians each facing a national poll.

The rest of the paper is organised as follows. In section 2 some alternative

interpretations of the benefits of democratisation are discussed. The model is presented in section 3, and in section 4 the optimal policy choices are characterised. The concluding section 5 discusses possible extensions.

## 2 The meanings of democratisation

The first advantage of a parliamentary decision compared to a Council decision is greater transparency of the former. Parliamentary debates are open to public while bargaining in the Council typically happens behind closed doors. This implies that the electorate is less informed about what politicians wanted to achieve and what they actually did. In particular, each national government can easily claim that it tried hard to promote the interests of its citizens but that it was unable to obtain a better deal. Thus, a national government can hide its true objectives behind the constraints imposed by the need to reach an agreement in the Council. The same goes for the restrictions imposed by European law. Citizens are unable to judge whether a decision they dislike was inevitable given the founding treaties, or whether the reference to European law is nothing but a pretext for taking unpopular decisions. In the Parliament, this problem is less severe since there is an opposition which has an incentive to disclose legal and other information to the public. In the main part of the present paper, this argument is formalised assuming that knowledge of the people about the actions of politicians is better in the case of a parliamentary decision than in a situation where the Council of Ministers is in charge.

The second way to fill the concept of democratisation with content is the idea of a double representative democracy. It is widely held that direct democracy leads to decisions which are closer to the people's interest than a representative democracy. If this is true, one may argue that this problem is twice as severe if European legislation is passed by the Council instead of the Parliament. In a parliamentary democracy, the citizens elect the members of parliament, and the parliament votes on the laws. Thus, there are two stages where votes are aggregated until a law is concluded. This is to be contrasted with the current European situation where voters elect their national parliaments, which elect the national governments, which in turn decide on the European laws. Here, I have a three-stage procedure of aggregation of votes. If one postulates that at every stage of the aggregation procedure, the resulting decision only imperfectly reflects the preferences to be aggregated, a flatter hierarchy is better than one with more stages. However, in order to make this argument precise one would have to look more carefully into the different procedures of aggregation.

The third benefit of a democratisation derives from the fact that both on a national and a European level some important decisions are taken. It is possible that the voters in a member state are satisfied with their government's national policy while they dislike its handling of European issues in the Council of Min-

isters. In such a situation, the citizens have to decide which domain of policy is more important and vote accordingly in the national election. If voters put more emphasis on national issues, as is currently the case, national governments will not be sanctioned for a bad European policy. Clearly, if the competences of the European Union are enlarged, this asymmetry could be reversed, and in national elections, European issues would dominate. The basic flaw of national governments deciding on European affairs would however remain: the voters have only one vote for two levels of government.

As a final motivation behind the claim for more democracy in Europe, one must mention the possibility that such a claim is not issued in good faith. Rather, one may suspect that it is only a pretext for delaying further centralisation of powers in Europe. In fact, national governments will hardly be ready to cede much power to the European Parliament in the near future. Contary to that, the monetary union has shown that a substantial transfer of power from the member states to the European Union with its current institutions does happen. Thus, whoever opposes a further vertical transfer of powers has an incentive to ask for democratisation as a prerequisite for a centralisation, knowing that this will not happen.

### 3 The model

The European Union is modelled as a collection of states numbered  $i = 1, 2, \dots, I$ . For each state  $i$ , a policy  $x_i$  is to be chosen. For simplicity, the policy is taken to be one dimensional. The vector of policies is denoted by  $\mathbf{x} = (x_i)_{i=1}^I$ , and the vector of policies for all states but  $i$  is  $\mathbf{x}_{-i} = (x_1, \dots, x_{i-1}, x_{i+1}, \dots, x_I)$ . Three allocations of power are considered. First, as a reference case, decisions could be taken decentrally. This means that each national government chooses the policy  $x_i$  relating to its state  $i$  without coordinating its activities with other national governments. As a second allocation of power the Council of Ministers may be in charge. Then, the vector of policies  $\mathbf{x}$  is chosen cooperatively by the governments of the member states. Finally, the ruling majority in the European Parliament may control the vector of policies  $\mathbf{x}$ .

#### 3.1 Citizens

Since the focus of the analysis is on the European Parliament's incentives to trade off voters in different states against each other, it is abstracted from conflicts of interest inside a country. Thus, all citizens of state  $i$  will enjoy the same welfare which depends on the policies  $\mathbf{x}$  and a random variable called the electoral shock. The electoral shock reflects the fact that citizens cannot observe the policies chosen by the government. They however do observe their own welfare which provides a signal about the actions of the politicians. It is assumed that the

electoral shock is the same in the cases of a decentralised and a parliamentary decision, since these two regimes seem to be equally transparent. Therefore, if the same vector of policies  $\mathbf{x}$  is chosen, the welfare experienced by citizens of state  $i$  is the same under these two allocations of power. To state the welfare function formally, the electoral shock is denoted by  $\epsilon_i$ , and welfare in the cases of a decentralised and a parliamentary decision is called  $u_i^D$  and  $u_i^P$  respectively. Assuming for simplicity that the shock is additive, one obtains

$$u_i^D(\mathbf{x}, \epsilon_i) = u_i^P(\mathbf{x}, \epsilon_i) = v_i(\mathbf{x}) - \epsilon_i.$$

If the Council of Ministers decides, the electoral shock is  $\delta_i$  and the citizens receive a welfare  $u_i^C$  given by

$$u_i^C(\mathbf{x}, \epsilon_i) = v_i(\mathbf{x}) - \delta_i.$$

In these expressions,  $v_i(\mathbf{x})$  is a utility function strictly increasing in the policy implemented in the state  $i$ , i.e.,  $\partial v_i / \partial x_i > 0$ . This derivative is essentially a convention, saying that policies are measured such that citizens prefer more of their home policy. The cross derivatives  $\partial v_i / \partial x_j$  may have either sign, depending on whether one has positive or negative externalities.

## 3.2 Electoral shocks

The electoral shocks  $\epsilon_i$  and  $\delta_i$  are assumed to be uncorrelated between states. Moreover, for each country  $i$ , the shock  $\epsilon_i$  is distributed according to the same cumulative distribution function  $F(\epsilon_i)$ . Similarly, all  $\delta_i$ ,  $i = 1, \dots, I$  have the same cumulative distribution function  $G(\delta_i)$ . The densities are denoted by  $f(\epsilon_i)$  and  $g(\delta_i)$  respectively. These random variables describe the link between the actions chosen by politicians and citizens' knowledge about these actions. The main assumption of the current paper is that this link is closer in the case of a parliamentary decision than in the case of a decision by the Council. Formally, this is expressed by assuming that the distribution  $G$  puts less probability weight on realisations which are close to the mean. A useful specification for this is

**Assumption 1** *Both  $\epsilon_i$  and  $\delta_i$  are distributed symmetrically around a mean of zero. Both densities  $f$  and  $g$  are increasing (decreasing) for negative (positive) shocks. There is some  $\hat{e} > 0$  such that  $f(e) \geq g(e)$  if and only if  $-\hat{e} \leq e \leq \hat{e}$ .*

Figure 1 illustrates this assumption.

The distributions of the electoral shocks determine how the citizens' assessment of the quality of the policy, measured by  $v_i(\mathbf{x})$ , reacts to the welfare signal they receive. Conditional on a signal  $u_i^P$ , citizens in state  $i$  believe that the quality of the policy chosen by the European Parliament was at least some value  $\bar{v}$  with probability

$$\text{Prob}_F\{v_i(\mathbf{x}) \geq \bar{v} | u_i^P\}.$$

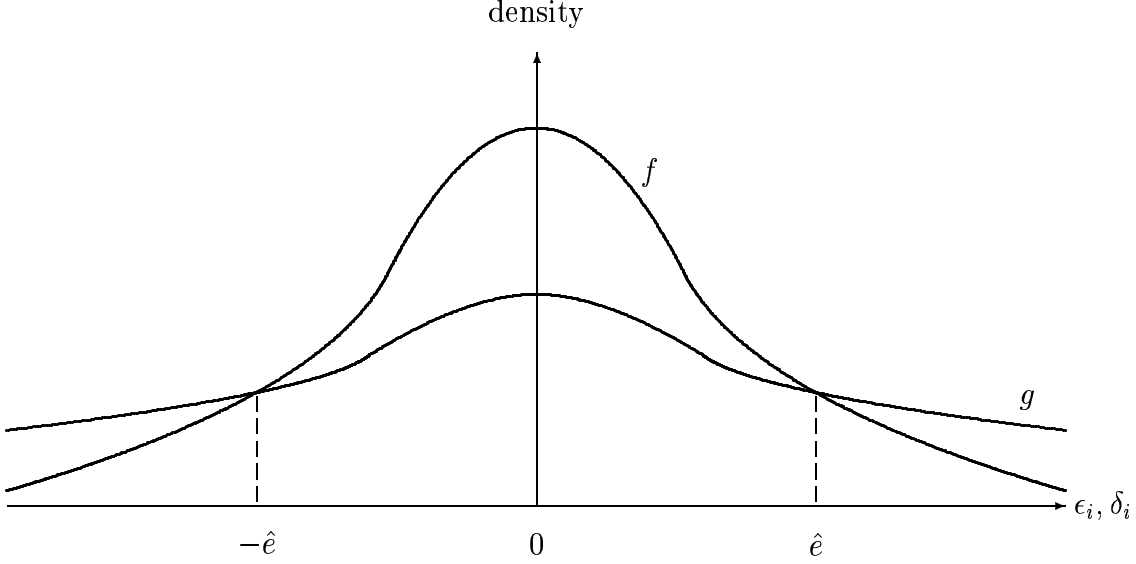


Figure 1: Densities of the electoral shocks with a parliamentary ( $f$ ) and a Council ( $g$ ) decision

Using  $u_i^P = v_i(\mathbf{x}) - \epsilon_i$ , this is equal to  $1 - F(\bar{v} - u_i^P)$ . Hence a marginal improvement of welfare leads to a marginal change in the assessment of the policy's quality given by

$$\frac{\partial \text{Prob}_F\{v_i(\mathbf{x}) \geq \bar{v} | u_i^P\}}{\partial u_i^P} = f(\bar{v} - u_i^P).$$

Analogously,

$$\frac{\partial \text{Prob}_G\{v_i(\mathbf{x}) \geq \bar{v} | u_i^C\}}{\partial u_i^C} = f(\bar{v} - u_i^C)$$

says how citizens' belief about the quality of the policy changes in response to a change in welfare if the Council is in power. The higher the density of the electoral shock, the closer is the link between the actions of the politicians and how the citizens perceive them. In this sense, Assumption 1 states that for values of the electoral shock close to zero, the procedures of the Parliament are more transparent than those of the Council.

### 3.3 Elections

Citizens in state  $i$  are assumed to vote for the incumbent government if they are satisfied. This means that their welfare is at least as large as a reservation utility  $\bar{u}$ , which for simplicity is assumed to be the same in all states. If power is decentralised, this happens with probability

$$\begin{aligned} \text{Prob}_F\{u_i^D(\mathbf{x}) \geq \bar{u}\} &= \text{Prob}_F\{v_i(\mathbf{x}) - \epsilon_i \geq \bar{u}\} \\ &= F(v_i(\mathbf{x}) - \bar{u}). \end{aligned}$$



Contrary to that, if the Council of Ministers is in charge,

$$\begin{aligned}\text{Prob}_G\{u_i^C(\mathbf{x}) \geq \bar{u}\} &= \text{Prob}_G\{v_i(\mathbf{x}) - \delta_i \geq \bar{u}\} \\ &= G(v_i(\mathbf{x}) - \bar{u})\end{aligned}$$

gives the probability that citizens in state  $i$  are satisfied with their government.

The incumbent majority of the European Parliament must seek reelection in the entire European Union. This occurs if they win support in at least  $k$  of the  $I$  member nations. Thus, it is implicitly assumed that all states carry the same weight in the European election. This simplifies the notation, while introducing different weights for the different states would not alter the message of the analysis.

To define formally the probability of reelection for the Parliament's majority, consider first the event that the citizens of exactly  $n$  countries are satisfied. For any such number  $n = 0, \dots, I$ , define the probability of this event by

$$p^n(\mathbf{x}) = \text{Prob}_F\{v_i(\mathbf{x}) - \epsilon_i \geq \bar{u} \text{ for } n \text{ states } i = 1, \dots, I\}.$$

The majority of the European Parliament will be reelected if the number  $n$  of countries where the population is satisfied is at least  $k$ . Thus, reelection occurs with the probability  $\sum_{n=k}^I p^n(\mathbf{x})$ . Since the electoral shocks are the same as in a decentralised situation, this probability is calculated using the distribution function  $F$ .

For later reference, denote by

$$p_{-i}^n(\mathbf{x}) = \text{Prob}_F\{v_j(\mathbf{x}) - \epsilon_j \geq \bar{u} \text{ for } n \text{ states } j \neq i\}$$

the probability that the citizens of exactly  $n$  states different from  $i$  are satisfied with the parliamentary majority. Using independence of the electoral shocks, the probability of reelection can be decomposed into

$$\sum_{n=k}^I p^n(\mathbf{x}) = \sum_{n=k}^{I-1} p_{-i}^n(\mathbf{x}) + p_{-i}^{k-1}(\mathbf{x}) \cdot F(v_i(\mathbf{x}) - \bar{u}). \quad (1)$$

In this expression, the first term on the right hand side is the probability that the ruling majority carries at least  $k$  states different from  $i$ . This is the probability of being reelected without the help of state  $i$ . In the second term  $p_{-i}^{k-1}$  is the probability that among all states except state  $i$ , exactly  $k - 1$  states vote for the incumbent. This is the probability that state  $i$  is pivotal in the election. This probability is multiplied with the probability  $F(v_i(\mathbf{x}) - \bar{u})$  that the citizens of  $i$  are satisfied with the incumbent. Thus the second term in this expression is the probability that winning state  $i$  is needed for reelection and that state  $i$  is indeed won.

### 3.4 Politicians

Politicians have two conflicting goals. On the one hand, they have preferences about the policies  $x_i$  which differ from the interests of the electorate. On the other hand, they want to be reelected. The first goal is summarized in a function  $c(x_i)$  with  $c' > 0$  and  $c'' > 0$  describing the effort costs for the politicians to carry out policy  $x_i$ . One need not interpret this function literally as the effort of working. Rather, it reflects the fact that by doing what the electorate wants, a politician must forego opportunities to give favours to specific interest groups, or he must compromise on his ideological convictions.

If the ruling government or parliamentary majority is reelected, this provides them a benefit of  $W$ . This stands for the pleasures of being in office such as salary, official cars, and appearances on tv. More importantly,  $W$  incorporates the benefit from being able to promote interest groups and ideology also in the following period. A national government in a decentralized system is reelected with probability  $F(v_i(\mathbf{x}) - \bar{u})$ . Thus, the objective of such a government is

$$-c(x_i) + F(v_i(\mathbf{x}) - \bar{u})W.$$

Similarly, but using the different electoral shock, the preferences of a national government in the Council of Ministers are given by

$$-c(x_i) + G(v_i(\mathbf{x}) - \bar{u})W.$$

Contrary to a decentralised decision, however, the Council coordinates decisions. Although it would be interesting to model explicitly the decision making process inside the Council, this is not done here. Since one can only speculate about this process, it is preferable to assume that the Council simply maximises the sum of its members' objectives. This yields

$$-\sum_{i=1}^I c(x_i) + \sum_{i=1}^I G(v_i(\mathbf{x}) - \bar{u})W.$$

The objective function of the ruling majority in the Parliament is of the same form but with the appropriate probability of reelection:

$$-\sum_{i=1}^I c(x_i) + \sum_{n=k}^I p^n(\mathbf{x})W.$$

Since the European Parliament is responsible for all policies implemented throughout Europe, it has to bear the effort costs of all those policies. Moreover, the objective functions all use the same cost function and the same value of reelection. This is motivated by the desire to abstract from any advantage of one of the institutions due to lower effort costs or higher value of reelection on the part of this institution's politicians.

## 4 Optimal policies

Instead of analysing the general framework outlined in section 3, three special cases are presented. These cases exemplify typical policy decisions in a federal context, and are sufficient to discuss the effects relevant for the assignment of powers.

### 4.1 No externalities

In this subsection policies are discussed which do not cause any physical nor fiscal externalities between the states. Examples for such policies are regulation of purely local environmental issues or education policies for immobile workers. The absence of externalities is modelled by specifying

$$v_i(\mathbf{x}) = x_i,$$

where the welfare of citizens in state  $i$  depends exclusively on the policy  $x_i$  chosen for this state. For simplicity, utility is taken to be linear in the policy. According to the normative theory of fiscal federalism, such policies should not be centralised. This case is nevertheless analysed because positively, one cannot be sure that the European Union confines itself to those functions where substantial externalities exist.

Using this specification one obtains the decision problem of a national government in a decentralized situation:

$$\max_{x_i} -c(x_i) + F(x_i - \bar{u})W.$$

Similarly, the decision problem for the Council of Ministers is

$$\max_{\mathbf{x}} -\sum_{i=1}^I c(x_i) + \sum_{i=1}^I G(x_i - \bar{u})W.$$

The probability that the majority of the European Parliament is reelected from (1) can be simplified due to the absence of externalities. In fact, for each state  $i$ , whether or not its citizens are satisfied only depends on the policy  $x_i$ . Thus, for all  $n$ , the probability  $p_{-i}^n(\mathbf{x})$  of winning  $n$  states different from state  $i$  does not depend on  $x_i$ . In a slight abuse of notation, it is therefore denoted by  $p_{-i}^n(\mathbf{x}_{-i})$ . This allows to write the Parliament's objective as

$$\max_{\mathbf{x}} -\sum_{j=1}^I c(x_j) + \left[ \sum_{n=k}^{I-1} p_{-i}^n(\mathbf{x}_{-i}) + p_{-i}^{k-1}(\mathbf{x}_{-i}) \cdot F(x_i - \bar{u}) \right] W.$$

In Proposition 1, interior optimal solutions  $\mathbf{x}^D$ ,  $\mathbf{x}^C$  and  $\mathbf{x}^P$  in the three allocations of power are characterised.

**Proposition 1** *If there are no externalities, a positive vector of optimal policies satisfies for all  $i = 1, \dots, I$ :*

$$\begin{aligned}
 \text{Decentralized solution :} & \quad c'(x_i^D) = f(x_i^D - \bar{u})W \\
 \text{Council of Ministers :} & \quad c'(x_i^C) = g(x_i^C - \bar{u})W \\
 \text{European Parliament :} & \quad c'(x_i^P) = p_{-i}^{k-1}(\mathbf{x}_{-i}^P)f(x_i^P - \bar{u})W.
 \end{aligned}$$

A politically optimal decision equates the marginal effort cost of a policy improvement to the marginal benefit of this improvement in the next election. This marginal benefit is given by the value of staying in office times the increase in the probability of winning the election brought about by a marginally better policy.

For the interpretation of proposition 1, first the decentralized and the Council decisions are compared. To fix ideas, let the decentralised optimum  $x_i^D$  be between the reservation utility  $\bar{u}$  and  $\bar{u} + \hat{e}$  as displayed in figure 2. This means that reelection is moderately valuable for the government relative to the cost of effort. The national politicians make sure that they have more than a fifty percent chance of staying in office, but it is not worthwhile for them to expand effort to the point where the densities  $f$  and  $g$  intersect. As can be seen from the figure, increasing marginal costs  $c'$  and a decreasing density  $g$  imply  $x_i^C < x_i^D$ .

In the case at hand, transferring power from the member states to the Council of Ministers reduces the quality of the policy. The government is punished more for a deterioration of policy in the decentralised situation than in the case where the Council is in charge because citizens are badly informed about European decision processes. This lack of transparency is not counteracted by any advantage of collective decision making in the Council since it was abstracted from externalities. A transfer of powers to the European level here appears to be motivated by a desire to cloud citizens' perception of political decisions.

The conclusion of the foregoing paragraph is reversed if the decentralized policy  $x_i^D$  is larger than  $\bar{u} + \hat{e}$ . This arises if parameters are such that reelection is far more important than the cost of effort. Then, the national government wants to make reelection almost certain by implementing a very good policy. However, if decisions are taken in the Council, at the same policy, reelection is less certain for the government, since the electoral shock has a greater variance. Consequently, a marginal improvement in policy has a greater impact on reelection prospects because there is still some probability mass left to gain by better actions.

Consider now a situation where the Council has implemented the policies  $\mathbf{x}^C$  and where by a sudden institutional reform, power is conferred to the Parliament. If the Parliament considers changing the policy for one state  $i$  in isolation, it will decrease  $x_i$  starting from  $x_i^C$  if

$$g(x_i^C - \bar{u}) > p_{-i}^{k-1}(\mathbf{x}_{-i}^C)f(x_i^C - \bar{u}). \quad (2)$$

Whether this is true depends on two countervailing effects. On the one hand, the Council decision is less transparent as is expressed by the difference between  $f$  and

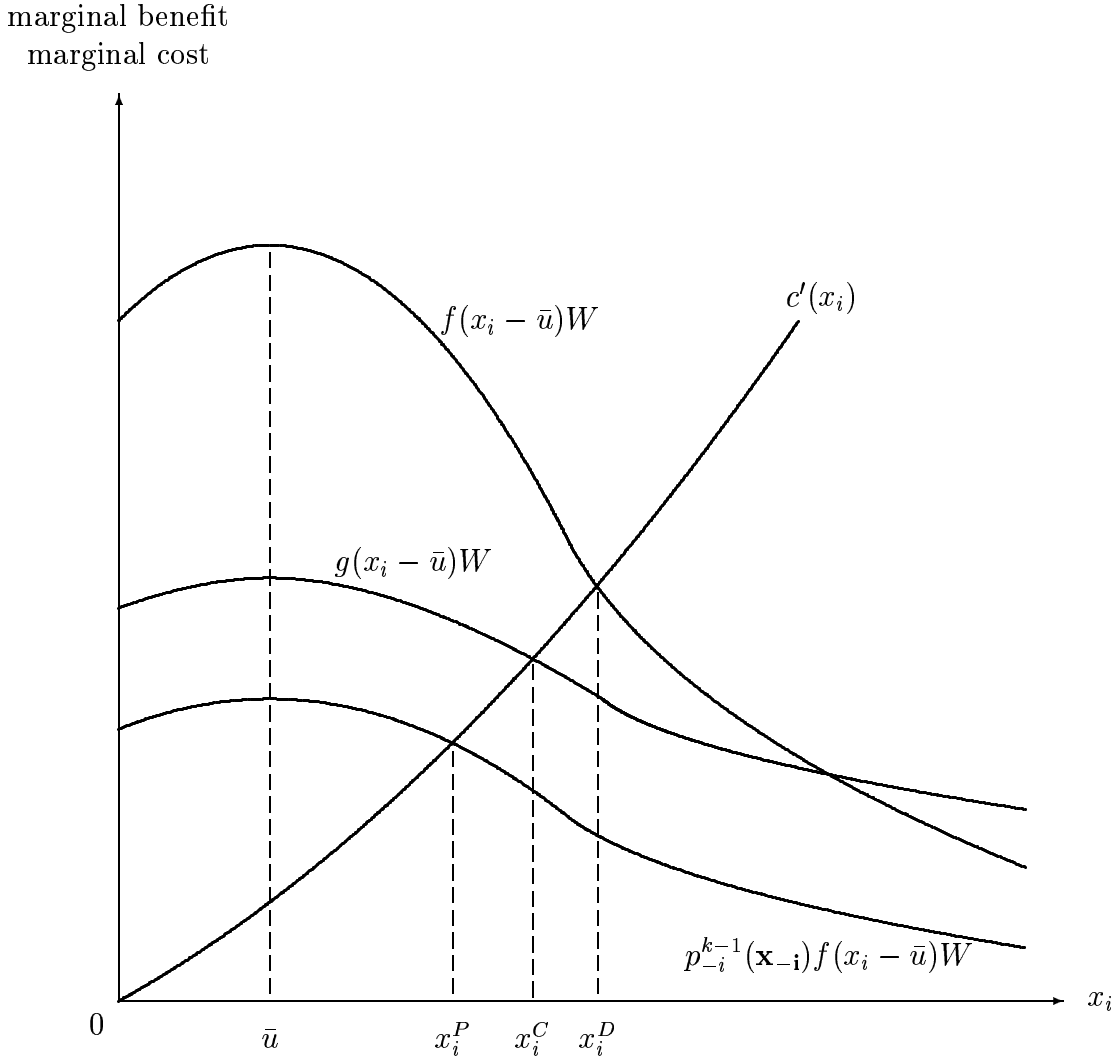


Figure 2: Optimal political choices in the absence of externalities

*g*. On the other hand, the Parliament is less accountable to any single nation's population. This second effect is represented by the fact that the density  $f$  in the marginal electoral benefit for the Parliament is multiplied by the probability  $p_{-i}^{k-1}$  that this nation is pivotal. The voting reaction of a state counts only insofar as this state is relevant for the overall outcome of the European elections. If inequality (2) holds, the second effect dominates the first one. In figure 2, this case is depicted. Inequality (2) there is illustrated by the fact that the function  $p_{-i}^{k-1}(\mathbf{x}_{-i})f(x_i - \bar{u})W$  passes below the graph of  $g(x_i - \bar{u})W$ . In such a situation, the Parliament respects the citizens' will less than the Council does.

One cannot make any global comparison between the optimal parliamentary and Council decisions based only on the vector  $\mathbf{x}^C$ . This is due to the fact that the probability  $p_{-i}^{k-1}$  depends in a complicated way on the entire vector of policies

for the states other than  $i$ . Thus, although at the Council decision vector  $\mathbf{x}^C$  it would pay off for the Parliament to reduce  $x_i$  a little if (2) holds, this need not be the case if the entire vector  $\mathbf{x}^P$  is chosen optimally.

## 4.2 European public goods

In the present subsection it is assumed that the benefit of any national policy is shared equally by all European countries. Examples for such European public goods are the common competition and free trade policies, or a common foreign and security policy, or the reduction of transfrontier pollution. Citizens' utility is specified as

$$v_i(\mathbf{x}) = \sum_{j=1}^I x_j = X.$$

Contrary to that, the politicians' effort costs are still assumed to depend only on the national policy  $x_i$ . Competition policy provides a justification for this modelling. In a common market, enforcing competition rules benefits all consumers in Europe, but the interest groups which are hurt by such a policy are typically regionally concentrated.

A decentralised decision about nation  $i$ 's contribution to the European public good is described by a Nash equilibrium. In such an equilibrium, each state solves for given  $\mathbf{x}_{-i}$

$$\max_{x_i} -c(x_i) + F(X - \bar{u})W$$

taking into account that  $\sum_{j=1, j \neq i}^I x_j + x_i = X$ . The Council decision about the national contributions to the European public good follow from the problem

$$\max_{\mathbf{x}} -\sum_{i=1}^I c(x_i) + \sum_{i=1}^I G(X - \bar{u})W.$$

If the European Parliament is in charge of providing the European public good, its objective is to

$$\max_{\mathbf{x}} -\sum_{i=1}^I c(x_i) + \sum_{n=k}^I p^n(X)W.$$

In the following proposition the first order conditions characterising optimal interior choices  $X^D$ ,  $X^C$  and  $X^P$  of the three institutions are presented.

**Proposition 2** *In each state, the same quantity of the European public good is chosen no matter who is in charge of the decision. If they are positive, the aggregate amounts of the public good which occur under the three different allocations of power satisfy the following necessary conditions:*

$$\text{Decentralized solution :} \quad c' \left( \frac{X^D}{I} \right) = f(X^D - \bar{u})W$$

$$\begin{aligned}
\text{Council of Ministers :} & \quad c' \left( \frac{X^C}{I} \right) = Ig(X^C - \bar{u})W \\
\text{European Parliament :} & \quad c' \left( \frac{X^P}{I} \right) = Ip_{-1}^{k-1}(X^P)f(X^P - \bar{u})W.
\end{aligned}$$

**Proof:** See Appendix.

Unlike the case of unrelated policies treated in proposition 1, the public good case exhibits a clear advantage of a centralised European decision. In the decentralised solution, the marginal effort cost is equated only to the national marginal electoral benefit of a contribution to the European public good. Contrary to that, the two European institutions take into account the electoral benefit in all states. This can be seen from the fact that in the equations for both the Council and the Parliament, the densities are multiplied by  $I$ . European institutions overcome the problem of national governments free riding on each other's efforts.

However, the need to coordinate policies does not say anything about the appropriate choice between the two European institutions. Instead, also in the case of European public goods, the tradeoff between transparency and accountability matters. The relative importance of these two problems, measured by comparing  $g$  and  $p_{-1}^{k-1}f$ , determines which European institution should be in charge. While there is a strong case in favour of centralising the decision on a European public good to *some* EU institution, the presence of externalities offers no argument for strengthening the rôle of the Parliament at the expense of the Council.

### 4.3 International Redistribution

The model can also be used to discuss how redistribution between the member states of the European Union will be performed by the European Parliament. This shifts the focus of the analysis away from conflicts of interest between politicians and citizens. When intergovernmental payments are made, politicians and citizens alike will prefer to be net recipients rather than net contributors. Thus, in this subsection, I assume that politicians and citizens in a state both prefer higher values of the policy for this state. The easiest way to do so is to abstract from effort costs by setting  $c(x_i) \equiv 0$ . In this subsection,  $x_i$  is simply interpreted as the resources spent in state  $i$ . Since redistributive payments are private goods, the utility function  $v_i(\mathbf{x}) = v(x_i)$  of the voters in state  $i$  depends only on the resources available in this state. In a utilitarian tradition, I assume  $v' > 0$  and  $v'' < 0$ .

The incumbent majority of the European Parliament chooses a policy to maximise its chances of reelection, taking into account the feasibility requirement imposed by the total amount of available resources  $E$ :

$$\max_{\mathbf{x}} \quad \sum_{n=k}^I p^n(\mathbf{x})$$

$$\begin{aligned} \text{subject to } & \sum_{i=1}^I x_i \leq E \\ & x_i \geq 0 \text{ for } i = 1, \dots, I. \end{aligned}$$

In addition to the feasibility constraint, nonnegativity constraints have to be satisfied for the resources spent in each state.

Setting up the Lagrangian and using the decomposition of the reelection probability given in (1), one finds the necessary conditions for an optimal choice of the parliamentary majority.

**Proposition 3** *Assume that an optimal international redistribution policy  $\mathbf{x}^P$  chosen by the European Parliament gives positive resources to countries  $i$  and  $j$ , i.e.,  $x_i^P > 0$  and  $x_j^P > 0$ . Such a policy satisfies*

$$p_{-i}^{k-1}(\mathbf{x}_{-i}^P) f(v(x_i^P) - \bar{u}) v'(x_i^P) = p_{-j}^{k-1}(\mathbf{x}_{-j}^P) f(v(x_j^P) - \bar{u}) v'(x_j^P). \quad (3)$$

The majority in the European Parliament reallocates resources until the last Euro spent in any country provides the same marginal increase in the chances of being reelected. This contribution is the product of three things. The last term on the left-hand-side of (3) is the marginal utility which this money provides the citizens in state  $i$ . The second term shows how this additional utility increases the chances for the parliamentary majority to win state  $i$ . Finally, the first term shows that this state only counts insofar as it is pivotal in the election.

Proposition 3 can describe two very different situations. First, a natural candidate for a solution is the egalitarian allocation  $x_i = E/I$  for all  $i = 1, \dots, I$ . With this allocation, the marginal utilities and the densities of the electoral shocks are evaluated at the same point for all states. Moreover, in a symmetric allocation, all states are equally likely to decide the election. Thus, the egalitarian allocation always satisfies the necessary condition (3). Moreover, it coincides with the utilitarian optimum which simply requires equality of the marginal utilities.

However, a very unequitable distribution may also satisfy the necessary condition. To see this, assume that there are just  $k$  favoured states which obtain high values of  $x_j$ , whereas the remaining  $I - k$  states get very small  $x_i$ . Then, for the disfavoured states, the marginal utility of additional money will be high, while it is low for the favoured states. Conversely, in normal circumstances, each of the favoured states is necessary to win the election because there are just enough of them to pass the threshold of  $k$ . This implies that these states are pivotal with a high probability whereas the disfavoured states most probably are irrelevant for the election. Thus, a high value of  $p_{-j}^{k-1}$  for the favoured states will exactly compensate the low marginal utility of income for these states, while the opposite is true for the disfavoured states. The Parliament therefore concentrates all its efforts on just enough states so as to be reelected, and exploits the other states in order to pay for this.



A simple numerical example shows that this is not a very remote case. Assume that there are only  $I = 2$  states where the vote of  $k = 1$  of them is sufficient to win the election. The electoral shock  $\epsilon_i$  is uniformly distributed on  $[-1/2, 1/2]$ , the utility function is  $v(x_i) = \ln x_i$  with a reservation utility of  $\bar{u} = 0$ , and total available resources are  $E = 2$ . After substituting  $x_2 = 2 - x_1$ , and observing that state  $i \neq j$  is pivotal with probability  $p_{-i}^0(x_j) = 1 - F(\ln x_j - \bar{u}) = (1/2) - \ln x_j$ , one finds the first order condition for an interior solution

$$\begin{aligned} & \frac{d[p_{-1}^0(x_2) \cdot F(\ln x_1 - \bar{u}) + F(\ln x_2 - \bar{u})]}{dx_1} \\ &= \left[ \frac{1}{2} - \ln(2 - x_1) \right] \frac{1}{x_1} - \left[ \frac{1}{2} - \ln x_1 \right] \frac{1}{2 - x_1} = 0. \end{aligned}$$

Differentiating once more yields

$$\begin{aligned} & \frac{d^2[p_{-1}^0(x_2) \cdot F(\ln x_1 - \bar{u}) + F(\ln x_2 - \bar{u})]}{dx_1^2} \\ &= \left[ \frac{x_1}{2 - x_1} - \frac{1}{2} + \ln(2 - x_1) \right] \frac{1}{x_1^2} + \left[ \frac{2 - x_1}{x_1} + \ln x_1 - \frac{1}{2} \right] \frac{1}{(2 - x_1)^2}. \end{aligned}$$

Evaluating this expression at the equitable allocation  $x_1 = 1$  yields 1. Hence, this is a local minimum of the reelection probability and the optimal choice necessarily involves an asymmetric distribution of resources.

In the case of decentralized decisions, no redistribution will occur. As long as unanimity is required, the same holds for a decision by the Council of Ministers, since every government will veto a policy imposing a net burden on its citizens. Contrary to that, majority decisions in the Council might well lead to inequitable transfers. However, the present high threshold for a qualified majority and the fact that the revenues of the European Union must be agreed upon unanimously limit the extent of such redistribution. Thus, it is to be expected that a European Parliament with true budgetary authority would have stronger incentives than the Council to favour some regions at the others' expense.

## 5 Conclusion

In this paper, it was argued that a transfer of powers from the Council of Ministers to the European Parliament does not necessarily lead to policies which are closer to the interest of the people. The tradeoff between a greater transparency of decision making in the Parliament, and a higher accountability on the part of the Council was pointed out. The latter is due to the fact that the national governments represented in the Council must win support in their home country in order to be reelected, while for the parliamentary majority, citizens in a state are only important if this state is pivotal in the European election.

To conclude, I mention two possible extensions. Following Seabright (1996), it was assumed that inside a state, the citizens share the same preferences. If instead interests in a country are heterogeneous, the national minorities are not represented in the Council. Therefore, Mueller (1995) advocates to assign those functions to the Parliament where winners and losers are equally distributed in space. Conversely, the Council is the right body to decide on issues where the benefits and costs are concentrated geographically. Dewatripont et al. (1995, p. 17 and p. 165-167) emphasise a similar point. They complain the under-representation of cross-border interests in the current EU institutions, and consider the European Parliament to be "the natural place for such representation" (p. 17). However, the problem of the Parliament's accountability does not disappear. It is true that the minority of a state will have more influence in the European election compared to the national poll. This gain is however offset by a corresponding loss of influence for the national majority. Thus, it would be an interesting task to integrate heterogeneity of preferences inside a state into the present model of political accountability.

A second extension concerns the interaction of the institutional arrangements on the European level with the vertical assignment of powers. For Germany, Blankart (1998, 1999) endogenizes this assignment. He argues that the *Länder* voluntarily transferred legislation on taxes and spending to the federal level. They did so in order to enforce a tax cartel, and because each state wants to free ride on the federal tax receipts. This argument carries a message for institutional reform in Europe. While a national government always has an incentive to make Europe pay for its regional public goods, a member of the Parliament should rather promote the European interest and withstand such desires. Hence, according to this argument, centralisation of powers should be less in the long run if the Parliament is the decisive body than if it is the Council. It is an open question how such considerations interact with the Parliament's lack of accountability pointed out in the present paper.

## Appendix

**Proof of Proposition 2.** In all three cases, the derivative of the second term in the objective function is independent of  $i$ . Together with  $c'' > 0$  this implies symmetry. The necessary conditions for the decentralised and the Council decision follow directly from the objective functions and  $\partial X/\partial x_i = 1$ .

Differentiating the Parliament's objective function yields for an interior solution

$$c'(x_i) = \frac{\partial \sum_{n=k}^I p^n(X)}{\partial X} W. \quad (4)$$

It remains to be shown that the derivative on the right-hand-side of (4) can be rearranged to yield  $I p_{-1}^{k-1}(X) f(X - \bar{u})$ . (This result is a special case of Seabright's

(1996, p. 87) conclusion. Here, a much simpler proof can be offered which exploits the restrictive assumptions used in subsection 4.2.) From independence and the fact that all states enjoy the same aggregate level of public good  $X$ , one has

$$\sum_{n=k}^I p^n(X) = \sum_{n=k}^I \binom{I}{n} [F(X - \bar{u})]^n [1 - F(X - \bar{u})]^{I-n}.$$

Differentiating with respect to  $X$  yields

$$\frac{\partial \sum_{n=k}^I p^n(X)}{\partial X} = \sum_{n=k}^I \binom{I}{n} [nF^{n-1}(1-F)^{I-n} - (I-n)(1-F)^{I-n-1}F^n] f$$

where both  $F$  and  $f$  are evaluated at  $X - \bar{u}$ . Regrouping terms yields

$$\begin{aligned} \frac{\partial \sum_{n=k}^I p^n(X)}{\partial X} &= \binom{I}{k} k F^{k-1} (1-F)^{I-k} f \\ &+ \sum_{n=k+1}^I \left\{ \binom{I}{n} [nF^{n-1}(1-F)^{I-n} - \binom{I}{n-1} [I - (n-1)] (1-F)^{I-(n-1)-1} F^{n-1}] \right\} f. \end{aligned} \quad (5)$$

The sum in (5) is equal to

$$\sum_{n=k+1}^I F^{n-1} (1-F)^{I-n} f \left[ \frac{I!n}{n!(I-n)!} - \frac{I!(I-n+1)}{(n-1)!(I-n+1)!} \right] = 0.$$

Hence, (5) reduces to

$$\begin{aligned} \frac{\partial \sum_{n=k}^I p^n(X)}{\partial X} &= I f \frac{(I-1)!}{(k-1)![(I-1)-(k-1)]!} F^{k-1} (1-F)^{I-k} \\ &= I f \binom{I-1}{k-1} F^{k-1} (1-F)^{(I-1)-(k-1)}. \end{aligned}$$

Now  $\binom{I-1}{k-1} F^{k-1} (1-F)^{(I-1)-(k-1)}$  is the probability that out of  $I-1$  states exactly  $k-1$  vote in favor of the incumbent. Since this probability is the same no matter which state is not included in the  $I-1$  states, it is equal to  $p_{-1}^{k-1}(X)$ . Q.E.D.

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