

**Robert Schuman Centre for Advanced Studies**

International Economic Integration, National Autonomy,  
Transnational Democracy: An Impossible Trinity?

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## ABSTRACT

This paper examines three hypotheses concerning the relationship between economic integration, the nation-state, and democracy. The first one, the “diminished democracy” hypothesis, claims that in an integrating world economy national policymakers are increasingly constrained in their ability to produce the public goods the voters demand. Actually, there is little empirical evidence to support this hypothesis. Even in the EU, where most markets are highly integrated, the absence of tax harmonisation has not led to a situation where national governments are forced to provide a lower level of public services than the citizens would otherwise wish. On the contrary, the average tax rates and levels of public service provisions of the poorer member states tend to rise to those of the richer countries.

In Europe the problem is not a “diminished democracy” at the national level, but a “democratic deficit” at the supranational level. According to the second hypothesis —“transnational federalism”— this deficit could be corrected by transforming the present Union into a federal state. Unfortunately, there is no indication that a majority, or even a significant minority, of Europeans are willing to sacrifice the core of national sovereignty in favour of a super-state. But this is not the only problem with the federalist hypothesis. The basic flaw is that in a federation of polities sharply divided along cultural, institutional and social lines, and lacking the sense of national solidarity generated by shared historical memories, any measure by the central government that differentially affects the citizens of the separate states or regions, creates serious problems of legitimacy. This means that the key democratic principle of final agenda control by the majority could not be satisfied. As a consequence, a federal Europe would face even more serious problems of democratic legitimation than the present EU.

The third hypothesis —“transnational constitutionalism” — acknowledges that democracy cannot flourish above the national level but points out that constitutionalism can, since the purpose of constitutional rules is not to enforce positive social rights, but to limit and control the use of power. In the past such rules were defined by the national constitutions, but in an increasingly interdependent world national power has to be disciplined also externally. This is the function of the European treaties, of the GATT/WTO rules, and of many specialised treaties dealing with such matters as human rights, environmental protection or animal welfare. Transnational constitutionalism can improve the quality of democracy domestically, for example by limiting the discretionary power of national executives.

## 1. THE “DIMINISHED DEMOCRACY” SYNDROME

It has been well said that political power has determined frontiers while economic power has the freedom of the world. As markets grow beyond national boundaries it becomes increasingly difficult to evade the question: can markets become international while politics remains national or even sub-national? It is clear that in an integrating world economy the effectiveness of some traditional instruments of policy is seriously eroded. For example, the greater the degree of openness of a national economy, the less effective Keynesian demand management will be as an instrument of domestic stabilisation policy. This is true because some portion of any additional government expenditure will be spent on imports from the rest of the world, so that some of the demand-creating effect of the expenditure is dissipated abroad.

The obsolescence of some policy instruments does not, however, imply that democratic polities are no longer able to satisfy the demands of their citizens. On the contrary, one of the indirect benefits of greater economic integration could be an added incentive to find more adequate solutions to old and new problems. Thus, the demand for more transparency in public decision-making, the search for new forms of accountability, and the growing reliance on persuasion rather than on traditional forms of governmental coercion, can be shown to be related, at least in part, to the process of growing economic and political interdependence among nations (Majone 1996a). Moreover, it is sometimes possible to transfer policy-making powers to a higher level of governance, so that what can no longer be done at the national level may be achieved through international co-operation. But under which conditions, within which limits is such a transfer possible and what are its implications for democratic politics? These are the issues with which this paper is concerned.

A heuristically useful starting point is a familiar result of international economics known as the Mundell – Fleming theorem or, more informally, as the “impossible trinity” or the “open-economy trilemma”. According to this theorem, countries cannot simultaneously maintain an independent monetary policy, capital mobility, and fixed exchange rates. If a government chooses fixed exchange rates and capital mobility it has to give up monetary autonomy. If it chooses monetary autonomy and capital mobility, it has to go with floating exchange rates. Finally, if it wishes to combine fixed exchange rates with monetary autonomy it has to limit capital mobility.

Economist Dani Rodrik has argued that the standard open-economy trilemma can be extended to what he calls the political trilemma of the

world economy (see Figure 1). The elements of Rodrik’s political trilemma are: integrated national economies, the nation-state, and “mass politics”, i.e. a democratic system characterised by a high degree of political mobilisation and by institutions that are responsive to mobilised groups. The claim, as in the standard trilemma, is that it is possible to have at most two of these things. To quote Rodrik: “If we want true international economic integration, we have to go either with the nation-state, in which case the domain of national politics will have to be significantly restricted, or else with mass politics, in which case we will have to give up the nation-state in favour of global federalism. If we want highly participatory political regimes, we have to choose between the nation-state and international economic integration. If we want to keep the nation-state, we have to choose between mass politics and international economic integration” (Rodrik 2000, 180).

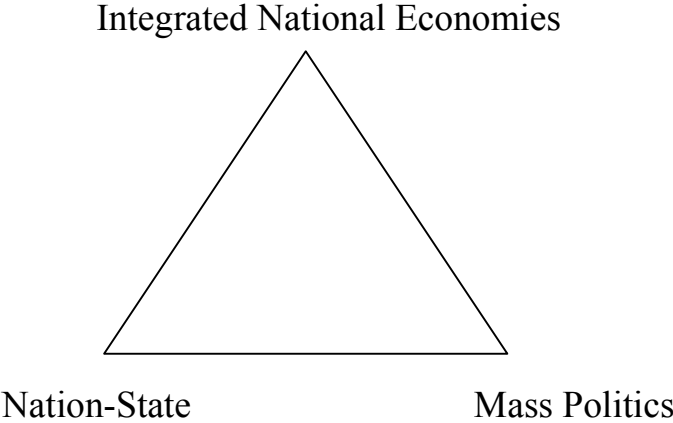


Figure 1: The False Trilemma  
(Source: Rodrik 2000, 181)

Politics would not necessarily shrink under global federalism since economic power and political power would then be aligned: all important political and policy issues would be treated at the global level. A world government is not in the domain of the politically possible, now or in the foreseeable future, but even without it we are not, in fact, faced with the stark trade-off envisaged by Rodrik between international economic integration and public responsiveness to the wishes of the citizens. According to him, the price of maintaining national sovereignty while markets become international is that politics has to be exercised over a much narrower range of issues: “The overarching goal of nation-states... would be to appear attractive to international markets... Domestic regulations and tax policies would be either harmonised according to international standards, or structured such that they pose the least amount of hindrance to international economic integration. The only local public goods provided would be those

that are compatible with integrated markets” (Rodrik 2000, 182). In essence, this is the “diminished democracy” thesis which has found wide, if uncritical, acceptance among critics of globalisation.

The core of this thesis is an argument about the declining ability of democratic policymakers to produce public policies that depart from market-conforming principles. However, numerous studies have cast serious doubts on the accuracy of any simple correlation, much less any causal link, between increasing globalisation and a “diminished democracy” syndrome. Thus, a recent econometric analysis using annual data from 1964 to 1993 for 16 OECD countries finds little evidence that international capital mobility exerts systematic downward pressure on the public sector, the welfare state, and public sector provisions (Swank 2001 and other studies cited therein).

These and other similar findings (see the next section) must appear counter-intuitive to many critics of the globalisation of trade, but they are quite understandable once we realise that the rules of the world trading system do not restrict the autonomy of national policymakers in any significant way. Members of the World Trade Organisation (WTO) not only enjoy domestic policy autonomy but must also respect the exercise of that autonomy by other members. This basic principle is reflected in the most-favoured-nation (MFN) principle, the fundamental function of which is to ensure that each WTO member accord access to its markets independently of any of the policies of the trading partner, including domestic policies.

Critics of globalisation also assert that under GATT and WTO rules a government cannot protect from import competition those domestic industries that have to bear the costs of environmental or other regulations not applied by other countries. As Roessler (1996) has convincingly shown, however, WTO rules do permit member states to take a domestic regulatory measure raising the cost of production in combination with subsidies or tariffs that maintain the competitive position of the domestic producers that have to bear these costs. The only restriction is that if the compensatory measures adversely affect the interests of other WTO members, procedures designed to remove the adverse effects of those measures on third countries must be observed.

A striking demonstration of the autonomy of national policymakers in politically sensitive matters is provided by the WTO Agreement on sanitary and phytosanitary (SPS) measures, i.e., national regulations to protect the health of humans, animals and plants. Under this Agreement each signatory has the right to set its own standards in the health field. This presumption of national autonomy can be challenged only by showing that a measure lacks

a scientific justification. If a health measure has a scientific basis there is little other countries can do to oppose it (Atik 1996-97). Operationally, the existence of a scientific basis is shown by a risk assessment performed according to internationally accepted methodologies (Majone 2002 a, where the attempt by the European Commission to replace the SPS criteria by the precautionary principle is discussed). It is precisely the combination of rigid rules with flexible safeguards that has permitted the liberalisation of international trade to proceed so far without any domestic policy harmonisation. This subtle compromise makes possible the coexistence of the two apparently opposing principles of domestic policy autonomy and the globalisation of trade (Roessler 1996, 41).

## 2. “SHALLOW V. DEEP” INTEGRATION

The arguments presented so far could be judged insufficient to challenge Rodrik’s pessimistic scenario or to disprove the “diminished democracy” hypothesis. It may be objected that the liberalisation of capital and goods markets is a form of “shallow” integration – integration limited to measures to remove controls and barriers that block exchange at national borders. As international economic integration progresses, however, such measures are no longer sufficient. Issues of “deeper” integration emerge on the international agenda. These issues concern behind-the-border policies and institutions that had previously not been subjected to international scrutiny (Kahler 1995, 2). Domestic regulatory regimes, in particular, may have to be replaced by internationally harmonised rules that cannot be tailored to national preferences. Hence, it is concluded, the real threat to the autonomy of democratically accountable policymakers comes from the harmonisation bias of deeper integration, or, to use Rodrik’s terminology, from *true* international economic integration.

An example of this line of reasoning is provided by the traditional view of international tax competition. According to this view, because of increasing economic integration capital becomes more footloose and countries begin to compete to attract it by cutting their tax rates (see Tanzi 1995 for a careful discussion of the possibility that tax competition may deteriorate tax systems). The process may reach a point where a country is forced to provide a lower level of public services than its citizens would otherwise wish. Given this scenario, tax harmonisation seems a reasonable proposition. At a minimum, if tax cutting is matched by all nations, no country gains a comparative advantage. Thus, international tax harmonisation would resemble price fixing cartels among firms—a very attractive strategy to all negotiating parties. In fact, one observes relatively

little tax harmonisation, even among countries whose economies are undergoing a process of deep integration.

By far the most important contemporary example of deep integration of originally separate national economies is represented by the European Community/European Union (EC/EU). Hence the process of European integration provides the most rigorous test of the hypothesis that international economic integration significantly reduces the capacity of democratically elected policymakers to provide the public goods the voters demand.

It has often been predicted, on the basis of the received view on tax competition, that a failure to harmonise taxation in the EU will result in a destructive competition among member states which will ultimately undermine Europe's generous welfare systems, but no such "race to the bottom" can be observed so far. While barriers to trade and to capital mobility have been falling almost continuously since the late 1950s, EU countries have not experienced any significant degree of tax competition and consequent fall of the tax rates. In fact, the average tax rates have been climbing since the mid-1960s both in the original member states — the Benelux countries, Germany, France and Italy—and in the countries of the European "periphery" — Spain, Portugal, Greece and Ireland. Moreover, tax rates have always been higher in the richer than in the poorer countries, showing that the growing integration of Europe did not make the richer members of the Community feel constrained by tax competition from low-wage countries. Since the late 1970s the difference between the tax rates of these two groups of countries has narrowed. However, this narrowing has gone in the opposite direction to that predicted by the tax competition view, with average tax rates in the peripheral countries approaching those of the richer countries. Rather than in a race to the bottom, the member states of the EU seem to have engaged in a race to the top.

There are also few signs that a race to the bottom in the provision of public services is taking place in the European Union. Rather, as in the case of taxation, the race has been in the other direction, with the southern countries upgrading to northern levels of expenditure (Barnard, 2000). In sum: even in a "deeply" integrated EU, "the nation-state is still the principal site of policy change, and there remains ample scope for political choice... if institutional arrangements and policy mixes are suitably modified, then the core principles of the European social model can be preserved and in many respects enhanced in their translation into the real worlds of European welfare" (Ferrera *et al.* 2001, 164). Also a scholar like Fritz Scharpf, who for years has warned about the significant decline in national problem-

solving capacity caused by globalisation and European (negative) integration, now acknowledges that there are still policy choices left, both at national and European levels, so that the welfare state is not impotent and is not doomed to wither away (Scharpf 1999).

To say that the rules of the world trade regime, the liberalisation of capital markets and even deep integration do not significantly reduce the autonomy of national policymakers is not, however, to imply that domestic policies do not have to be adapted to constantly changing economic, political and technological conditions. Welfare states everywhere face serious problems, but the causes of the current difficulties are mostly related to factors that have little to do with the growing integration of the world economy: the impact of demographic changes, domestic opposition to high tax rates, the failure of traditional social policies to respond to new needs and risks generated by socio-economic and technical change, ideological and political shifts.

### **3. DEEP INTEGRATION AND HARMONISATION**

The “diminished democracy” thesis is sometimes combined with a demand for more international harmonisation. In recent years the idea that the harmonisation of domestic policies and institutions is a necessary precondition of free and “fair” trade, has assumed a central position in the debate about globalisation. Paradoxically, many of the same people who oppose international economic integration because of the constraints that it allegedly imposes on national policy preferences, demand the reduction or even the elimination of domestic diversity in environmental, labour, and social policies. Jagdish Bhagwati (1996) has critically examined the philosophical, economic and political arguments that have been advanced in order to justify such demands. His conclusion is that most such arguments are technically unsound, and some even lead to morally objectionable conclusions.

Thus, philosophical arguments to reduce diversity, and hence to limit the autonomy of national policymakers, often result from a sense of obligation that citizens of rich countries feel towards the citizens of poorer countries. This sense of moral obligation seems to legitimate the demand that rich countries should use their economic and political power to persuade and, if necessary, coerce weaker countries into adopting higher environmental and social standards. However, the enforcement of higher standards is costly. Unless rich countries are prepared to help poorer countries to meet such costs, the demands of international harmonisation of environmental and social standards tend to distort the national priorities of

the developing countries, and even to be captured by economic interests in the rich countries. This explains why “overarching environmental demands on resource-strapped nations, backed by a threat of punitive trade sanctions, may be made not just by environmental groups, but also by protectionist lobbies who see the resulting possibility of trade sanctions as a benefit to themselves” (Bhagwati 1996, 13).

Probably the earliest debates on policy harmonisation arose in the 1950s, in connection with the creation of the European Economic Community. A trace of those debates may be found in the Treaty of Rome, for example in Article 119 (now Article 141 EC) which states that men and women should receive equal pay for equal work. The article was introduced at the demand of France, which feared the competition of other members of the Community in sectors such as textiles employing a high proportion of female workers. The problem arose because France had introduced, before the establishment of the Community, legislation imposing equal pay for men and women, while other European countries had not. As a result, the relative wage of women was higher in France than elsewhere. Hence it was feared that the liberalisation of trade within the common market would handicap the French industry (Sapir 1996, 552).

In general, however, the Treaty of Rome rejected the idea that the harmonisation of social policies should precede the establishment of the common market. Instead, the treaty assumed that such harmonisation would follow as the consequence of the higher standard of living made possible by the liberalisation of trade and the integration of the national economies. Hence, differences in social policies need not be addressed if they reflect general economic conditions. Differences that create specific distortions should be eliminated, but harmonisation of national policies is only one of the methods that can be applied (Sapir 1996, 551). The treaty also rejects the idea that economic integration requires tax harmonisation. The soundness of this approach is demonstrated by the fact, noted above, that no race to the bottom in taxation has taken place in the EU, despite deepening integration.

Still, harmonisation may be needed to the extent that national laws and regulations create non-tariff barriers to trade, and hence “directly affect the establishment or functioning of the common market” (Article 94, EC Treaty). The nature of regulatory harmonisation, however, has changed radically over the years.

#### **4. THE EVOLUTION OF REGULATORY HARMONISATION IN THE EU**

From the early 1960s to about 1973 – the date of the first enlargement of the EC to the United Kingdom, Ireland and Denmark – the European Commission's approach to harmonisation was characterised by a distinct preference for detailed measures designed to regulate exhaustively the problems in question to the exclusion of previously existing national regulations – the approach known as total harmonisation. Under total harmonisation once EC rules have been put in place, a member state's capacity to apply stricter rules by evoking the values referred to in Article 36 of the Treaty of Rome (now Article 30 EC) – the protection of the health and life of humans, animals and plants, and the preservation of national cultural treasures – is excluded.

For a long time the Court of Justice supported total harmonisation as a foundation stone in the building of the common market. From the point of view of market building, total harmonisation has the advantage of simplicity. Once the Community has acted, national regulations no longer apply: the common market operates under a common set of rules. This corresponds to federal pre-emption: the Community enjoys exclusive competence over the relevant policy area (Weatherill 1995).

To compensate the loss of regulatory sovereignty by the member states, Article 100 of the Treaty (now Article 94 EC) prescribed that harmonising directives proposed by the Commission had to be unanimously approved by the Council before they could become European law. This unanimity requirement forced the Commission and the Council to engage in lengthy and sometimes fruitless bargaining. It is easy to imagine the difficulty of totally harmonising the laws and regulations of six, nine, twelve and finally fifteen countries differing widely in political, legal and administrative traditions. Even the process of adapting existing European regulations to technical progress was so slow as to produce a systematic regulatory lag.

It is possible that a lack of historical precedents led to a serious underestimation of the difficulty of total harmonisation. However, the main reason of the preference for this approach to market integration was political. In the early days of the Community, harmonisation tended to be pursued not just to solve concrete regulatory problems but also to drive forward the general process of European integration. Eventually, however, this political use of total harmonisation ran into growing opposition from some member states, particularly after the first enlargement.

By the mid-1970s the limits of the approach had become clear. As the Commission was to admit some years later, “[e]xperience has shown that the alternative of relying on a strategy based totally on harmonisation would be over-regulatory, would take a long time to implement and could stifle innovation” (Commission of the European Communities 1985, 17). At the same time, mounting opposition to what many member states considered excessive centralisation convinced the Commission that the powers granted by Article 100 had to be used so as to interfere as little as possible with the regulatory autonomy of the national governments. The emphasis shifted from total to “optional” and “minimum” harmonisation – and to mutual recognition.

Optional harmonisation aims to guarantee the right of free movement of goods while permitting the member states to retain their traditional forms of regulation. Thus a food speciality, such as cheese made from non-pasteurised milk, not conforming to European standards may still be produced for the domestic market.

A particular form of optional harmonisation is provided by the fourth paragraph of Article 100 a (now Article 95 EC), added to the Treaty of Rome by the Single European Act. This article introduced qualified majority voting for internal market legislation, but the member states were not prepared to give up their veto power, under Article 100, without some weakening of total harmonisation. Hence, Article 100a (4) provides that: “If, after the adoption of a harmonisation measure by the Council acting by a qualified majority, a Member State deems it necessary to apply national provisions on grounds of major needs referred to in Article 36, or relating to protection of the environment or the working environment, it shall notify the Commission of these provisions”.

The national provisions are valid once the Commission has verified that they are not a means of arbitrary discrimination or a disguised restriction on trade. Thus Community harmonisation does not necessarily exclude the possibility of regulatory action by the member states, where this is shown to be justified. Article 100 a (4) specifies the permissible grounds for setting national rules that differ from the Community standard, and introduces a system of controls involving the Commission as well as the other member states. Neither restriction applies to the method of minimum harmonisation. Under this method the national governments must secure the level of regulation set out in a directive but are permitted to set higher standards, provided of course that the stricter national rules do not violate Community law. Like optional harmonisation, minimum harmonisation liberalises trade without suppressing justifiable regulatory diversity. In the

areas where minimum harmonisation is the rule – environment, consumer protection, occupational health and safety — the member states retain competence, and thus can adapt Community measures to national preferences. In addition, many EC directives contain options and exemptions which allow governments to exercise discretion in the implementation of Community measures with which they are uncomfortable.

The introduction of the principle of mutual recognition in the late 1970s was another important step towards a more flexible regulatory system. According to this principle, as stated by the Court of Justice in the famous *Cassis de Dijon* decision, a member state cannot prevent the marketing within its borders of a product lawfully manufactured and marketed in another member state. This philosophy was later generalised by the Commission to cover not only traded goods but also services, as in the case of the mutual recognition of professional degrees and diplomas. Mutual recognition provides a framework of general rules within which different regulatory approaches can compete. The end result is *ex post*, or bottom-up harmonisation achieved through market-like processes rather than through imposition by central regulators as in the case of *ex ante*, or top-down, (total) harmonisation.

The trend toward decentralised forms of governance has become unmistakable in recent years. Article 3b of the Treaty on European Union (now Article 5 of the EC Treaty), which enacts the principles of attribution of powers, subsidiarity, and proportionality, effectively rules out of court the notion of a Community continuously moving the boundary posts of its own competence without explicit treaty revision (Dashwood 1996, 113). Moreover, the TEU defines new competences in a way that limits the exercise of Community powers. For example Article 126 adds a new legal basis for action in the field of education, but the measures the EC can take in this field are limited to “incentive measures” (e.g., programmes such as ERASMUS, the scheme for the mobility of university students within the EU) and to recommendations. Any harmonisation of national laws and regulations is excluded. Similarly, Article 129 creates specific powers for the Community in the field of public health, but the competence is highly circumscribed as subsidiary to that of the member states. Harmonisation is again ruled out, even though the article states that health protection requirements shall form a constituent part of the other EC policies. The other provisions of the TEU, defining new competences in such areas as culture, consumer protection, and industrial policy, are similarly drafted. In sum, rather than rely on implicit competences, whose limits seemed out of control, the TEU opted for an explicit grant that delimits the modes of action

and the reach of such policies (Weiler 1999). With very few exceptions, the same approach has been followed by the framers of the Amsterdam and Nice Treaties.

At the beginning of this section it was pointed out that for a long time the European Court of Justice supported total harmonisation as a basic principle of market integration. This method of harmonisation, it will be recalled, pre-empts action by the member states in the areas to which it applies. Recently, however, the ECJ has reduced the extent to which national powers need be pre-empted, even in the core area of regulation of intra-Community trade. Thus, in the joined cases *Keck and Mithouard* (1993, ECR I-6097) the Court pronounced that, “contrary to what has previously been decided”, the application to products from other member states of national provisions restricting or prohibiting certain marketing methods does not violate Article 30 of the Treaty of Rome — which forbids, *inter alia*, regulatory barriers to trade between the member states — provided the measures apply equally to all traders operating within the national territory, and affect equally the marketing of all products. Since *Keck and Mithouard* the Court has exempted a number of national regulations from the scope of Article 30 (now Article 28 EC), such as measures prohibiting Sunday trading, provisions regarding mandatory closing hours, and legislation limiting the sale of tobacco products to authorised retailers (Friedbacher 1996).

The move from total to optional and minimum harmonisation, and to mutual recognition; the restriction of total harmonisation to basic regulatory objectives; the fact that harmonisation has been explicitly ruled out for most new EU competences; not least, the jurisprudence of the ECJ referred to above-- are all indications that in a number of policy areas the Union has retreated from the classical pre-emption model. The fundamental reason of this retreat has been explained by Stephen Weatherill: “Total harmonisation confers on the Community an exclusive competence which it is simply ill-equipped to discharge... The Community lacks the expertise and the institutional maturity to exclude the participatory role of national authorities” (Weatherill 1995, 154).

## **5. EUROPE’S DEMOCRATIC DEFICIT**

At this point, it may be useful to summarise the argument presented in the preceding pages. We started by considering the diminished-democracy hypothesis, according to which in an integrating world economy national policymakers are increasingly constrained in their ability to produce the public goods the citizens demand. There is, however, little empirical

evidence that policy choices in democratic countries have been significantly restricted by the various processes that, together, constitute what is generally understood as globalisation. Thus, contrary to what is often asserted, the rules of the GATT/WTO regime leave member countries with full autonomy to pursue domestic policies within their jurisdiction. The rules step in only when domestic policy measures have protectionist purposes or effects, or when they seek to interfere with the policy autonomy of other countries.

In the European Union, we further noted, markets for goods, services and factors of production are deeply integrated, while most member states have adopted a common currency. Here, then, we have the best possible test of the hypothesis that under deep integration the domain of national politics has to be significantly restricted. In fact, the member states of the EU remain, for their people, the real arena for democratic politics. As we saw, the initial attempts to create a common market by the equivalent of federal pre-emption, have largely failed: the Community simply lacks the material and normative resources to exclude the participation of the national authorities from the European policy-making process. Hence the process of European integration seems to refute Rodrik's trilemma: even without regional federalism it is after all possible to integrate national economies without eliminating the nation-state, and preserving (and, as we shall argue, even improving) the quality of democratic processes at national level. In other words, in the EC/EU the problem is not a diminution of democracy at national level. At issue, rather, is a "democratic deficit" at the supranational level, that is, the absence or incomplete development of democratic institutions and processes that the citizens of the Union take for granted in their own countries. At the same time, however, this deficit of supranational democracy appears to be necessary not only for economic integration, but also to protect the rights of citizens even against their own governments and thus to improve the quality of democracy in the member states. The explanation of this apparent paradox is the main objective of the second part of the present paper.

A recurrent theme in the debate about the "democratic deficit" of the EC/EU is that the powers of the European Parliament (EP) still fall far short of the powers of an ordinary parliament, while the Commission — a bureaucratic body — continues to enjoy a nearly total monopoly of legislative initiative. This is essentially an argument by analogy since it tends to equate European institutions with familiar national institutions — a parliament with an independent power of legislative initiative, an executive responsible to parliament, popular elections to decide who shall govern — or at least to assume that EU institutions will converge towards such a model (Majone 1998). The most obvious objection to the analogy with the model of

parliamentary democracy — in any of its national variants — is that the institutional architecture of the EC/EU has been designed by treaties duly ratified by national parliaments. One of the characteristic features of this architecture is the impossibility of mapping functions onto specific institutions. Thus the Community has no legislature but a legislative process in which different institution — Council, EP and Commission — have different parts to play. Similarly, there is no identifiable executive, since executive powers are exercised for some purposes by the Council acting on a Commission proposal; for other purposes (e.g., competition matters) by the Commission; and overwhelmingly by the national administrations implementing European policies on the ground (Dashwood 1996, 127).

Such institutional arrangements are certainly unusual by the standards of the classical separation-of-powers doctrine, but they serve essential functions. Thus, if the treaties make the legislative powers of the Council and the EP dependent on a proposal from the Commission, this is to link more closely both Council and EP to European law, and to enhance the credibility of national commitments to the integration process. For example, if also the Council had the right to initiate legislation, it could use this power to turn back the clock of European integration, perhaps for short-run political advantages. More generally, the institutional architecture of the EC does not correspond to any contemporary model of democratic governance but to the much older model of “mixed government”, where democracy plays a role, but does not represent the ultimate basis of legitimacy (Majone 2002 b).

Another significant difference between the national and the European levels of governance is the fact that the Community is a system of limited competences. As already noted, a more precise delimitation of Community powers was a major result of the TEU. Article 3b of the treaty (now Article 5 EC), which enacts the principles of attribution of powers, of subsidiarity, and of proportionality as organising principles of the constitutional order of the Union, marks a shift in the Community’s deep structure (Dashwood 1996, 113).

In addition to the constitutional limitations one must also consider the material limitations. The EU has no general taxing and spending powers similar to those held by national governments; and with a budget of less than 1.3 per cent of Union GDP which, moreover, must always be balanced, it can only undertake a limited range of policies (Majone, 1996 b). These limitations on the powers of the EC/EU are important also from a normative viewpoint because questions of legitimacy are basically questions about the use of power. Hence, standards of legitimacy and accountability historically

developed to control an omniscient state with virtually unlimited powers to tax and spend, cannot be applied without substantial modifications to a system of limited competences and resources such as the EC/EU.

### 6. THE POLITICAL TRILEMMA AGAIN

While the vast majority of the citizens of the EU support deep economic integration because of its obvious advantages in terms of consumer choice and the free movement of people and goods, there is no evidence that a majority, or even a sizeable minority, are in favour of establishing a European super-state. But let assume, for the sake of argument, that national leaders in a moment of self-denying euro-enthusiasm decided to create a United States of Europe (U.S.E.), and that the national parliaments duly ratified the new federal constitution. Naturally, this constitution would effect a significant transfer of powers to the European level. In addition to the regulatory and monetary powers which the EU already possesses, the U.S.E. would have, as a minimum, an independent power to tax and spend and exclusive competencies in foreign and security matters.

Such transfer of powers would entail a severe loss of sovereignty for the member states, but sovereignty is not the issue with which we are concerned here. Rather, we want to investigate the implications of the federalist hypothesis for the viability of participatory democracy at the transnational level (see figure 2).

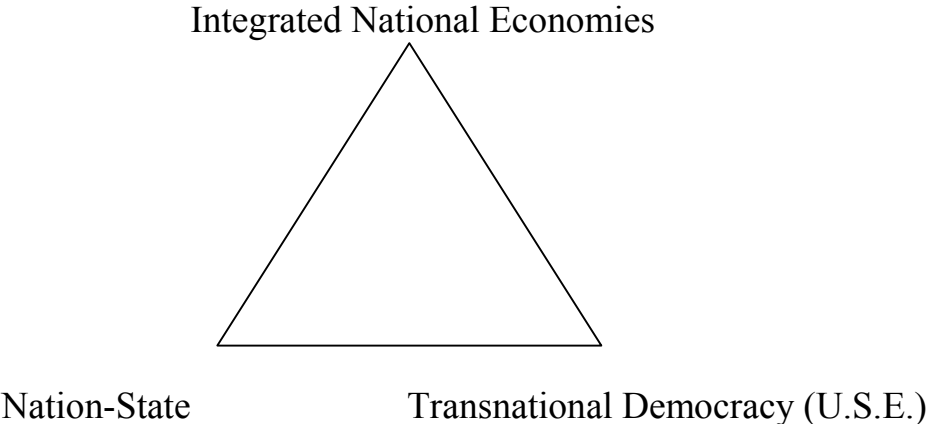


Figure 2: The Real Trilemma

According to Rodrik’s argument mentioned in section 2, a European federation should permit “mass politics” to flourish. Politics would simply relocate there, just as in the USA “the most contentious political battles... are fought not at the state level, but at the federal level” (Rodrik 2000, 183).

But this is hardly a useful way to think about the issue of transnational democracy in Europe since, as James Buchanan writes: “It is mockery to use “federalism” or “federal union” in descriptive reference to the United States... which is, of course, simply a very large nation-state” (Buchanan 1990, 6). While, directly or indirectly, the U.S. government can regulate or control most of the activities of the state or local governments, it is highly unlikely that something like this will ever be true in Europe.

Any federal union in Europe would have to respect the historical, cultural and institutional diversity which is the hallmark of the old continent. In particular, it would have to respect what a distinguished historian has called the most fundamental peculiarity of European society — the absolute primacy of the territorial state over all competing principles of social cohesion (McNeill 1974). It may be useful to point out that the idea of the primacy of the territorial state has the same origin as the idea of democracy, namely in the Greek polis. Cleisthenes (about 570 to 508 BC) is regarded as the founder of Athenian democracy. His most important innovation was the basing of individual political rights and duties on citizenship of a locality rather than membership in a clan. In this way, Cleisthenes brought the territorial principle to triumph over the kinship principle or other possible principles of social organisation. This explains at least in part why, even today, it is still so difficult to think about democracy outside the framework of the nation-state and why, therefore, the very notion of transnational democracy appears so problematic.

Democratic theory presupposes a territorially based *demos*, but there is no European *demos*, let alone a European nation. The absence of a European *demos* implies, *inter alia*, that a basic criterion for the democratic process could not be satisfied at European level. This is the criterion of final agenda control which Robert Dahl (1989, 113) formulates as follows: “the *demos* must have the exclusive opportunity to decide how matters are to be placed on the agenda of matters that are to be decided by means of the democratic process”. If the criterion cannot be satisfied at European level, as we show below, then it follows that the “diminished democracy” thesis — the argument about the declining ability of democratic policymakers to provide the public goods the citizens demand — is more likely to be true in the case of a European federal state than at national level .

It is important to understand clearly why the criterion of final agenda control cannot be satisfied in a federation composed of states deeply divided along cultural, social, institutional and economic lines. Observe, first, that like the democratic process itself, the majority principle presupposes the existence of a fairly homogeneous polity. Only in such a polity are majority

decisions considered legitimate and hence accepted also by the outvoted minority. In fact, empirical research has shown conclusively that, in polities divided into virtually separate sub-societies with their own political parties, interest groups and media of communication, the majority principle is often rejected in favour of non-majoritarian institutions (Lijphart 1984; Lijphart *et al.* 1993). This research is clearly relevant to the European Union — and *a fortiori* to a would-be European federation.

Now, non-homogeneous polities find it very difficult, if not impossible, to pursue redistributive and other policies with clearly identified winners and losers. Redistribution of income and wealth is a zero-sum game since the gain of one group in society is the loss of another group. Public decisions concerning redistribution can only be taken by majority vote because any issue over which there is unavoidable conflict is defeated under any more inclusive rule. It follows that in a transnational federation all such policies would have to be excluded from the public agenda as being too divisive. This is the main reason why redistributive social policy plays such a small role in EU governance (Majone 1996b).

It is true that the funds allocated to regional redistribution have grown considerably in recent years. It not clear, however, that regional redistribution should be considered an instrument of social policy rather than a side-payment to induce the poorer member states to accept deep economic integration. The problem with the former interpretation is that there is an important distinction between reducing inequality among individuals (the main objective of social policy) and reducing disparities among regions. Since most regions contain a mix of rich and poor people, a policy aimed at redistributing resources to a poor region may be implemented in such a way as to favour mostly rich individuals within that region. The problems of targeting regions to achieve a better distribution of personal income are particular severe in federal systems. Even in the United States, where the federal government pays three-quarters of the cost of welfare assistance, states insist on defining the standards of need and setting the benefit levels. As a consequence, the level of welfare assistance among the American states varies widely, more so than interstate disparities in wage rates or cost of living (Peterson and Rom 1990). In Europe too the countries which benefit most from regional aid, foremost among them Spain, are strongly opposed to individualised transfers of EU funds.

In sum, the delicate value judgements about the appropriate balance of efficiency and equity which social policies express, can be made legitimately only within fairly homogeneous polities. It is difficult to see how generally accepted levels of income redistribution could be determined

centrally in a federation where levels of economic development and political, administrative and legal traditions differ widely, and where, therefore, majoritarian principles can play only a limited role. The inclusion of income redistribution in the public agenda of a transnational federation would not improve its democratic legitimacy, but only increase the level of conflict among its constituent states. In the situation envisaged here, even the democratic legitimacy of a popularly elected federal parliament would be questioned. This is because the parliament — which is supposed to represent a non-existent transnational *demos* — would be unable to respond to national demands and thus would be viewed as an imperfect form of democratic representation, when not as an instrument of centralisation. Already in 1862 Lord Acton analysed the intrinsic limitations of parliamentary representation in imperial Austria in very similar terms. The conclusion of the great liberal historian was that “in those countries where different races dwell together... the power of the imperial parliament must be limited as jealously as the power of the crown, and many of its functions must be discharged by provincial diets, and a descending series of local authorities” (Lord Acton 1967 [1862], 156).

Which policies then could be legitimately included in the agenda of a European federal state? Aside from foreign and security policy, the public agenda would mostly include efficiency-enhancing, market-preserving policies — a combination of liberalisation and “negative integration” i.e., measures to remove obstacles to the free movement of people, services, goods and capital within the territory of the federation. Unlike redistribution, efficiency issues may be thought of as positive-sum games where everybody can gain, provided the right policy is adopted. In principle, efficient policies could be adopted by unanimity. The unanimity rule guarantees that the result of collective choice is efficient in the Pareto sense, since anybody adversely affected by a collective decision can veto it. Naturally, unanimity is practically impossible in a large polity because of high transaction costs and the possibility that the veto power may be used strategically, but there are second-best alternatives such as supermajorities or delegation of problem-solving tasks to non-political expert agencies. The important point for the present discussion is that efficiency-enhancing policies do not need a strong normative foundation: the substantive legitimacy provided by accountability-by-results is generally sufficient. Redistributive policies, on the other hand, need the procedural legitimacy of majority rule and hence place too heavy a burden on the fragile normative foundation of a transnational polity.

## 7. MARKET-PRESERVING FEDERALISM

Returning to Figure 2, we have shown that the viability of a transnational democratic polity — such as a would-be European federation — requires not only an irrevocable transfer of national sovereignty, but also a very constrained public agenda. Hence, the principle of full agenda control could not be satisfied and democracy would be seriously diminished. Note that this is true even if a majority of the citizens of the transnational polity support a given measure, as long as the opponents of the measure are concentrated in a few member states where they are actually a majority of the voters. In a federation of polities sharply divided along linguistic, political and institutional lines — and lacking the sense of national solidarity generated by shared historical memories — any measure by the central government that differentially damages (or favours) the citizens of the separate states or regions within its territory, creates serious constitutional and legitimacy problems.

For these reasons, the only kind of federalism that could be viable in today's Europe is the one Barry Weingast calls “market-preserving federalism”. A federal system is market-preserving if it satisfies three conditions: 1) Member states have primary regulatory responsibility over the economy; 2) A common market is ensured, preventing the national governments from using their regulatory authority to erect trade barriers against the goods and services from other member states; 3) The member states face a hard budget constraint, meaning that they have neither the ability to print money, nor access to unlimited credit (Weingast 1995, 4). By and large, these conditions are already satisfied in the European Union. The first condition holds because of the limited role of total harmonisation and because of national autonomy in fiscal matters; condition 2 corresponds to the strict prohibition of any unjustified obstacle to intra-Community trade — what has been referred to as “negative integration”; while condition 3 corresponds to the criteria the member states must satisfy in order to qualify for membership in the European Monetary Union. Thus, a federal Europe could not do much more than what the Union is already doing in the socio-economic area, without creating insoluble legitimacy problems.

To round off our discussion of the political trilemma of economic integration, we briefly consider the case of confederation. It will be recalled that confederations are associations of independent states that in order to secure some common purpose, agree to certain limitations on their freedom of action and establish some common machinery of deliberation and decision. A measure of transnational democracy could be achieved, for example through direct popular election of the legislative assembly or of the

chief executive. The problem is that confederations typically lack institutions strong enough to ensure the economic integration of the component units. Thus the Articles of Confederation (1781-9) that preceded the federal constitution of the United States, established a Congress of the confederation as a unicameral assembly of representatives, each possessing a single vote. Although the Congress was given authority in important areas such as foreign affairs, defence, and the establishment of coinage and weights and measures, it lacked both an independent source of revenue and the institutional means to establish a common market among the former colonies. Also the constitution of the Swiss Confederation of 1815 proved unable to create a common market out of the local economies of the 22 cantons. Economic integration was achieved only by the stronger federal constitution of 1848.

In sum, the confederal solution preserves national sovereignty and can also achieve a modest level of democracy, but at the expense of economic integration. The federal model, on the other hand, presents a double risk. If the federal government — which we assume to have an independent power of taxation — is strong enough to create a common market, it may be also strong enough to centralise, sooner or later, all important policy decisions. History suggests that this development is most likely in fairly homogeneous polities such as the United States, Germany or Australia. The opposite risk arises in the case of a deeply segmented polity. In such a case, as we saw, the federal agenda would have to be so severely restricted that people would continue to look to their own state governments for the solution of their problems. As a consequence, participative democracy could not flourish at the federal level.

## **8. DEMOCRACY AND ITS TRANSFORMATIONS**

We have reached the conclusion that democracy as we know it — a system of government responsive to the wishes of the citizens — could not thrive in a European federation or in any other transnational polity whose component units are divided by deep historical, cultural, economic and other cleavages. The absence of a strong feeling of national solidarity means that social and other policies which historically have legitimated the nation-state, could not be transferred to the higher level of governance: transnational democracy would be, at best, a diminished democracy. Before discussing the broader implications of this conclusion it is important to point out that the theory and practice of democracy have changed dramatically in history. Dahl (1989) identifies three crucial transformations. The first transformation took place during the first half of the fifth century BC when several Greek city-states which had been governed by monarchs, aristocrats or tyrants, were

transformed into systems in which a substantial number of citizens were entitled to participate in governing. Political decisions came to be taken by a majority vote preceded by free public debate. Direct citizen participation, not only in law-making but also in administration, was such an essential element of the Greek idea of democracy that Greeks found it very difficult to conceive of representative government, much less to accept it as a legitimate alternative to direct democracy.

While it is difficult to exaggerate the significance of the Greek experience for human civilisation, for the purpose of the present discussion it is important to appreciate the limitations of the classical view of democracy. From a contemporary democratic perspective, one crucially important limit of Greek democracy was that citizenship was highly exclusive, both internally and externally (Dahl 1989, 20-23). Within the city-state, a large part of the adult population (women, long-term residents, and their descendants, slaves) was denied full citizenship. Externally, the exclusiveness of classical democracy is revealed by the fact that genuine federal systems — as distinct from leagues or confederacies, often under the guidance and control of a hegemonic city — failed to develop in Greece. Every attempt to establish a true federation “was shipwrecked on the inability of the Polis to moderate its love of autonomy and fit itself into a larger whole” (Ehrenberg 1969, 118-9): the face of the polis, as Ehrenberg writes, was almost completely turned inwards. And because Greek democracy lacked the means and the desire to extend the rule of law beyond the narrow limits of the city-state, in their external relations the city-states lived in a state of almost continuous warfare – until peace was forced on them by a foreign power, first Macedonia and then Rome.

The exclusiveness of Greek democracy had serious consequences also in the area of *individual* rights. It is a much discussed question to what extent the freedom of the polis included the freedom of the individual. At any rate, it meant freedom *within* the state and not freedom *from* the state (Ehrenberg 1969, 95). This is why nineteenth century liberals like Benjamin Constant argued that the modern conception of liberty – as a private sphere of choice protected by individual rights — differs radically from the ancient conception of liberty as citizens sharing in public decision making and the exercise of power. *A fortiori*, Greek democracy failed to acknowledge the existence of universal claims to freedom, equality or human and political rights. Only after the breakdown of the polis in the second century AC did a new conception of universal individual rights emerge. In place of a law rooted in the tradition of a single city-state the Stoic philosophers proposed a law for the “city of the world”. In place of the exclusiveness of Greek democracy, they advanced the new conception of a world-wide human

brotherhood, the idea that men are by nature equal, despite differences of race, rank and wealth (Sabine 1960, 151-8). Thus Stoicism revised the political ideas of the city-state to fit the reality of the new transnational societies created by the Hellenistic and Roman empires.

The second democratic transformation took place two thousand years after the first one. It resulted from the union of democracy with representation — the possibility that a legislative assembly might legitimately consist not of the entire body of citizens but only of their elected representatives. It is instructive to observe that representation was not invented by democrats but developed instead as a medieval institution of monarchical, aristocratic and mixed government, and of the conciliar movement in the Church. This is not the only case of non-democratic institutions being adopted in order to extend and improve the practice of democracy. Another important example is constitutionalism (see section 9) which, in its modern form, was first theorised by Bodin (1530-1596) and by Althusius (1557-1638).

Through the institution of representation, it became possible to extend to idea of democracy to the large domain of the nation-state. To quote Dahl (1989, 30): “Thus the idea of democracy, which might have perished with the disappearance of city-states, became relevant to the modern world of nation-states. Within the far larger domain of the nation-state, new conceptions of personal rights, individual freedom and personal autonomy could flourish. Moreover, important problems that could never be solved within the narrow limits of the city-state... might be dealt with more effectively by a government capable of making laws and regulations over a far larger territory. To this extent, the capacity of citizens to govern themselves was greatly enhanced”.

Representative democracy presents another important advantage: it makes possible the existence of a civil society separate from the state and independent from it. Direct democracy, as practised by the Greeks, meant citizen participation not only in law-making but also in administration. Such total devotion to public affairs was possible only in a society founded on slave labour, hence the paradox, pointed out by Rousseau in Book III of the *Social Contract*, that perhaps liberty can be maintained only on a basis of slavery: “extremes meet”! Because life in the polis was so completely politicised, it was impossible for the citizens to carve out a sphere of private values and beliefs. By contrast, the separation of state and civil society, in particular of politics and economics, became one of the corner stones of liberal representative democracy.

Thus, the second transformation simultaneously contracted and expanded the limits of democracy. Direct participation by the demos in the making and implementation of laws was no longer possible, but it became feasible to extend democracy and the rule of law to an entire nation-state. The sense of community nurtured by repeated interactions in face-to-face assemblies was lost, but the individual gained protection and security against the discretionary power of an omniscient majority. It became impossible to assume a widely shared conception of the public interest, but the democratic nation-state could accept a much greater diversity of groups and interests than the polis, and prove that such diversity need not be destructive of the polity.

We are now in the midst of a dramatic change, a third transformation, in the scale of decision making as more and more policy competences are transferred from the national to the transnational level-- or are exercised jointly by the two levels. In the following pages I suggest that the implications of the third transformation for the theory and practice of democracy will likely be quite different from those of the second transformation. The challenge for democrats today is less to build full-fledged democratic institutions at the transnational level — an impossible task, we argued, in the absence of a *demos* — than to use the higher level in order to improve the quality of democracy at national and sub-national level. The experience of the European Union shows that a rule-based system of co-operation and dispute resolution can not only civilise relations among sovereign states by eliminating the excesses of narrowly conceived national interest; by protecting the rights of citizens even against their own governments, such a system strengthens the foundations of liberal democracy which have been eroded by decades of unlimited executive discretion. In this sense, the “virtuous triangle” of Figure 3 may represent the third transformation of democracy in an increasingly interdependent world.

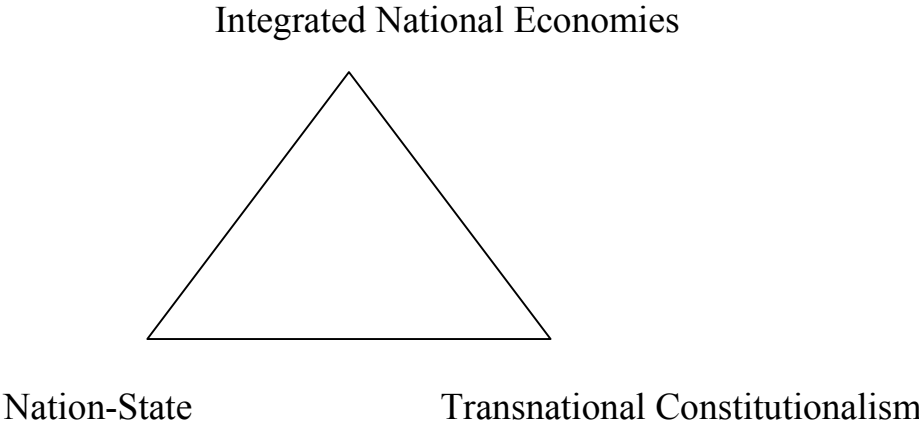


Figure 3: The Virtuous Triangle

## 9. TRANSNATIONAL CONSTITUTIONALISM

All contemporary western democracies are constitutional democracies, but “democracy” and “constitutionalism” are historically and conceptually distinct ideas. While a constitution is an instrument to limit, control and divide the power of governments, democracy — at least in its populist version — tends to concentrate potentially unlimited power in the hands of the current majority. According to the populist model, majorities should be able “to control all of government — legislative, executive and, if they have a mind to, judicial — and thus to control everything politics can touch” (Spitz 1984, quoted in Lijphart 1991, 485). By contrast, constitutional rules are exempted from the majoritarian controls that govern ordinary legislation and are enforced by apolitical courts. The effect of such rules is to remove certain decisions, for example concerning fundamental rights, from the electoral process and thus to tie the hands of the current majority.

It is not difficult to understand why some democrats consider the expression “constitutional democracy” an oxymoron — a combination of contradictory ideas. Yet, more careful reflection soon reveals why a constitutionally unconstrained democracy is not only more unstable but also less efficient than a liberal, constitutional democracy. To understand the positive role of constitutional limitations, it may be helpful to keep in mind the general principle that constraints can be “blessings in disguise” in the sense that it is often possible to take advantage of them. The familiar phenomenon of friction is a good illustration (Majone 1989).

In somewhat similar fashion, constitutional constraints can improve the efficiency of democracy, for instance by limiting arbitrary discretion and enhancing the credibility of long-term policy commitments. One of the defining features of democracy is that it is a form of government *pro tempore* (Linz 1998). The time limit inherent in the requirement of elections at regular intervals is one of the main arguments for democracy, but it also implies that the policies of the current majority can be subverted, legitimately and without compensation, by a new majority with different and perhaps opposing interests. This may be expressed by saying that in a democracy political property rights — the rights to exercise public authority in a given policy area — are ill-defined (Moe 1990). The uncertainty created by the lack of well-defined political property rights is one aspect of the commitment problem of democratic leaders. The other aspect is represented by the discretionary powers of the government between elections. Discretionary policymaking leads to the phenomenon of “time inconsistency”. Time inconsistency occurs when a government’s optimal long-run policy differs from its optimal short-run policy, so that the government in the short-run has an incentive to renege on its long-term

commitments. Without a binding rule holding it to the long-run policy, the government may switch to what now appears to be a better policy. The problem is that if people anticipate such a policy switch, they will behave in ways that prevent policymakers achieving their original objective.

For example, a policy of low inflation may be optimal in the long run. But at any time there can be short-run political gains from surprise inflation. If the policymakers have the possibility of revising the original policy to achieve such short-term gains, private actors will recognise this and change their behaviour in such a way that the outcome is worse than if the *ex ante* optimal policy had always been adhered to. One way to solve this particular time-inconsistency problem is to delegate monetary policy to a central bank whose independence is constitutionally guaranteed, as is the case with the European Central Bank (Majone 2001). Again, we saw that the Treaty of Rome assigns to the Commission the monopoly of legislative initiative, so that neither the Council nor the Parliament can initiate policy without a previous proposal from the Commission. This monopoly of legislative initiative, which in itself is a serious violation of the principles of parliamentary democracy, is best understood as a form of pre-commitment: if also the Council or the EP had the right to initiate Community legislation, this would mean that these political institutions could renege on their commitment to European integration, and thus compromise the core of the *acquis communautaire*.

But the influence of the European rules on the political life of the member states goes a good deal deeper than our example suggests. Constitutional scholars have written about the “eclipse of constitutionalism” in twentieth century Europe (Matteucci 1993, 161-68). During this period, the need to tax, spend and borrow to finance two world wars and extensive welfare provisions greatly increased the economic role of the state. The constitutional consequence was to strengthen the executive branch of government. The assumption of macroeconomic responsibilities by the “Keynesian state” further extended the already wide discretionary powers of the executive. In the end, it was inevitable that an old constitutional truth would be rediscovered: that discretionary powers can be abused and that the prevention of such abuse is, at least in part, a matter of institutional and constitutional design (Harden 1994, 615). In Europe the rediscovery of the virtues of constitutionalism was greatly facilitated, perhaps even made possible, by the integration process.

Recall that Keynesian policies require not only extensive discretionary powers to “fine-tune” the economy, but also the separateness of the national economies. The creation of a common European market and

the attendant rules of market liberalisation and negative integration meant that governments could no longer pursue protectionist policies within the EC, nor tolerate the existence of public or private monopolies within the national borders. The discipline imposed on state subsidies and on the criteria of public procurement further reduced the discretionary powers of the national executives — and the various forms of rent-seeking and political corruption which usually accompany administrative decisions in these areas. The rules and institutions of monetary union represent another important constitutional limitation on the unconstrained discretionary policies of the past.

It would be quite wrong to assume that the impact of supranational constitutionalism on the national level is limited to the economic sphere. Through the principle of “direct effect” and in other ways, the European Court of Justice has progressively extended the rights of individuals under EC law, and the duties of national courts to protect those rights, even against the national governments. For example, Article 190 of the Treaty of Rome (now Article 253 EC) imposes a reason-giving requirement on all European institutions. When the Rome Treaty was drafted, there was no general requirement to give reasons in the law of the member states, so that these constitutional provisions were not only different from, but in advance of, national laws. Even today, for example, English public law still lacks a general obligation on public administrators to give reasons for their decisions.. Nonetheless, the ECJ is quite prepared to impose such obligation upon the national authorities in order that individuals be able to protect their rights under European law. Thus in the *Heylens* case (Case 222/86[1987]ECR4097), the Court reasoned that effective protection requires that the individual be able to defend his or her right under the best possible conditions. This would involve judicial review of the national authority’s decision restricting that right. For judicial review to be effective, however, the national court must be able to call upon the authority to provide its reasons (Thomas 1997, 218). The powers of the ECJ to exercise constitutional and administrative review not only over all Community acts, but also over many acts of the member states, are by now well established.

Nothing like the ECJ exists at the international level, but significant progress in the constitutionalisation of international economic relations has been made in the framework of multilateral institutions like the International Monetary Fund and, especially, the GATT/WTO. In the latter case, particular importance attaches to the mechanisms of dispute resolution. Trade disputes under the WTO are now subject to binding adjudication in an institution that looks more and more like an international court. Today’s situation is a striking contrast to the early days of GATT, when the “working

parties” set up to report on disputes between member states were really a forum for encouraging negotiation, not a third-party investigation for the purpose of coming to objective conclusions on the merits of the case. It was not until 1952 that the member states resorted to the panel procedures which have become the standard means of dispute resolution within the GATT/WTO. Panels no longer included representatives from the disputing parties, and major trading nations were no longer automatically panel members.

The Uruguay Round (1986-1994) led to a new *Understanding on Rules and Procedures Governing the Settlement of Disputes*. The Understanding creates an automatic right in a complainant country to the creation of a panel, unless a consensus exists to refuse the panel. In 1984 the member states were asked to submit the names of qualified *non-governmental* experts who might serve on panels. The Uruguay Round Understanding goes even further, and dictates the expansion and improvement of the non-governmental roster. Above all, the Understanding created an integrated dispute settlement mechanism for all parts of the GATT/WTO system, to be administered by a Dispute Settlement Body (DSB). A new appeal process was also introduced. Appeals from panel decisions are possible on matters of law to panels of three drawn from a rotating pool of seven persons of demonstrated expertise in international trade appointed by the DSB, and who are to be available at all times on short notice. The Appellate Body is to submit its report within sixty days of an appeal being filed. After the first years of application of the Understanding there seems to be a widespread opinion that the WTO procedures for settling disputes are quite successful. They have been heavily utilised and have become an integral part of international economic diplomacy (Trebilcock and Howse 1995; Jackson 1997).

## 10. CONCLUSIONS

The constitutionalisation of the EC/EU and the evolution of dispute-resolution mechanisms in the GATT/WTO are outstanding examples of a general trend: the transition from a power-oriented to a rule-oriented approach to international relations. Under the former approach, international disputes are settled by negotiations where the relative bargaining power of the parties inevitably counts a great deal. Failure to reach agreement would involve the use of all instruments of retaliation — economic, political, possibly even military — available to the more powerful country. Understandably, a small country would hesitate to oppose a large one on whom its trade and international position depend. Under a rule-oriented approach, on the other hand, disputes are resolved by reference to norms

which both parties have agreed. An unsettled international dispute would ultimately be resolved by impartial third-party judgements based on explicit rules. Thus, negotiators would be negotiating with reference to their respective predictions as to the outcomes of those judgements, and not with reference to the power at the disposal of the various parties to the dispute (Jackson 1997, 109-110).

A rule-based system has obvious advantages for the smaller or poorer members of the international community: as the Greek sophists taught more than two thousand years ago, the strong does not need laws. Hence the movement towards a rule-based system of international relations mirrors, and in a sense recapitulates, the process of progressive constitutionalisation of democratic governments during the last two centuries. What is perhaps even more important, transnational constitutionalism can improve the quality of democracy at the national level. A power-oriented approach favours the use of executive discretion and the secrecy of traditional diplomacy. By contrast, a rule-based system facilitates democratic accountability, citizen participation and public debate. This is because international rules — not only the rules of GATT/WTO or other international organisations, but also treaties dealing with environmental protection, human rights or European integration — have to be ratified by national parliaments, may be subject to popular referenda, and are open to the scrutiny of courts, interest groups, NGOs and scholarly opinion.

In short, the greatest contribution of transnational constitutionalism to the idea and practice of democracy consists, to paraphrase Joseph Weiler (1999, 341), in affirming the values of the liberal nation-state by policing its boundaries against abuse. Now, the main lesson of European integration is that supranational rules can be quite effective even without the traditional state monopoly of coercive power — provided they are monitored and enforced by strong institutions like the European Commission and the Court of Justice. The recent strengthening of the WTO as an organisation suggests that this lesson has been learned by the international community. In order to move from a power-based to a rule-based approach to international relations, therefore, democratic states must be prepared to delegate significant powers to international organisations. We have argued that it is both unrealistic and unhelpful to demand that such organisations be evaluated according to the democratic standards we apply to the institutions of the nation-state. Actually, even at the national level the role of non-majoritarian institutions like constitutional courts and politically independent central banks and regulatory agencies, has been growing continuously in recent years. Thus, in an increasingly interdependent world the third transformation of democracy cannot consist in a mechanical

extrapolation of democratic principles and institutions to areas and levels of governance where democracy, as we know it, cannot flourish. Rather, parliaments and electorally accountable policymakers will have to devise more effective ways of enforcing accountability on non-majoritarian institutions at national and supranational level, while respecting their independence.

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