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# Optimality and Authority: A Critique of Neoclassical Theory

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GARY MARKS

and

LIESBET HOOGHE

*University of North Carolina at Chapel Hill*

## Abstract

The extent to which authority is centralized varies greatly across time and space, as the experience of Europe over the past half century illustrates. This article initiates a dialogue between two literatures: the neoclassical theory of authority and the analysis of multi-level governance. Neoclassical theory examines the tension between the benefits of centralization and the costs of imposing uniformity across diverse territories. It implies that multi-level governance is the optimal response to this trade-off. This article critically examines the assumptions of neoclassical theory, and offers some building blocks for an alternative approach.

## I. Introduction

European integration has revealed just how flexible the territorial articulation of authority can be.<sup>1</sup> States are merely one possible form of governance. One may conceptualize a dimension of variation from state-centric governance,

<sup>1</sup> This article began as a response to Charlie Jeffery's thoughtful critique of regional mobilization and multi-level governance published in a previous issue of this journal. In responding to Jeffery's article, the authors were led to summarize some ideas about how to explain multi-level governance that they had been discussing, mainly among themselves, for two or three years. We would like to thank Charlie Jeffery for

where authority within a given territory is centralized at a single level, to multi-level governance, in which authority is dispersed across regimes at numerous levels. These are the extreme possibilities. In the real world, we almost never find pure stateness or pure multi-level governance. Strong states generally have some form of local governance, and multi-level polities, such as Belgium in the European Union (EU), tend to concentrate authority at a limited number of levels. Nonetheless, the variation that we find across time and space in the territorial articulation of authority is remarkably wide, and it begs for explanation. This article initiates a dialogue between two literatures that exist in isolation from each other: the neoclassical theory of authority (Alesina and Spolaore, 1997; Alesina and Wacziarg, 1998, 1999; Barro and Sala-i-Martin, 1995; Besley and Coate, 1999; Bolton and Roland, 1997; Buchanan and Faith, 1987; Casella and Frey, 1992; Casella and Weingast, 1995; Friedman, 1977; Romer, 2000), and the analysis of multi-level governance (Ansell *et al.*, 1997; Bache, 1998; Benz and Eberlein, 1999; Falkner, 1999; Hooghe, 1996; Hooghe and Marks, 2001; Jachtenfuchs and Kohler-Koch, 1995; Leibfried and Pierson, 1995; Jeffery, 1997, 2000; Marks, 1993; Marks *et al.*, 1996; Scharpf, 1994, 1999). Most readers of this journal are familiar with the second of these literatures. We therefore focus on the first.

In the next section we outline the neoclassical theory of authority. In the following sections we critically examine the assumptions underlying neoclassical theory, and we offer some building blocks for an alternative theory. Transaction costs, ideology, rulers' private preferences, and coalitions – these, we argue, are neglected by neoclassical theory, yet they are key ingredients for a valid causal theory of authority.

## II. The Neoclassical Theory of Authority

### *Multi-level Governance as an Optimal Solution*

The neoclassical theory of authority builds on a key insight of the literature on public finance and fiscal federalism: the tension between the economic benefits of centralization and the undesirability of imposing uniform policy on a geographically diverse population (Alesina and Spolaore, 1997; Alesina and Wacziarg, 1999; Bolton and Roland, 1997). As we show below, the logical implication of neoclassical theory is that multi-level governance is the optimal way of allocating competencies in response to the trade-off between the benefits of scale and the costs of heterogeneity.

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putting this in motion, and John Peterson for his patience in shepherding the project into publishable form. We are indebted to Gerald Schneider with whom we had many discussions on the neoclassical theory of authority during our summer fellowships at the University of Konstanz in June 2000. Thanks also to the reviewers for their thoughtful comments.

Wider territorial scope of authority brings several economic and coercive benefits. It gives rise to economies of scale in the provision of public goods; it allows more efficient forms of taxation; it provides the possibility of compensation to subnational regions that are hit by region-specific economic shocks; it allows for more efficient redistribution; and, most importantly, it enlarges the territorial scope of market exchange if there is no overarching liberal trade regime. In addition, larger states are (other things being equal) more powerful players in international relations and produce more extensive security for their citizens. This is the conclusion of an extensive literature on the rise of the national state and the failure of city-states and state-lets in the course of European state-building (Tilly, 1975, 1990; Spruyt, 1994). Large states can take advantage of economies of scale in the production of coercive and economic resources that underpin international power and, by definition, they pacify larger areas and populations. Both an economic logic and a coercive logic, therefore, predict the extension of states.

An example used by Alesina and Wacziarg illustrates the logic of neoclassical theory.<sup>2</sup> If citizens had homogeneous preferences, how would one determine the government level at which street lighting would be provided? A disinterested ruler (a 'social planner') would determine the optimal territorial scope of government in the light of relevant economies of scale and externalities, and then pick a tax rate to finance the public good in the most cost-efficient way (Alesina and Wacziarg, 1999, p. 18). If the light of the lamp produces light for the whole street, then the ruler should devolve authority to all people living in the street and everyone should be forced to pay their share of taxes to finance the street lamp. The optimal level of government would be the street.<sup>3</sup>

The real world, of course, is more complicated. For one thing, provision of street lighting does not exhaust relevant economies of scale. Public lighting involves considerable fixed costs, including the cost of maintaining a reliable electricity supply. An electricity generator would undoubtedly be too expensive for the street to finance, but probably not for the city. So the optimal level

<sup>2</sup> Formally, this trade-off may be summarized in the following equation (Alesina and Spolaore, 1997), where the utility of an individual  $i$  is

$$U_i = g(1 - al_i) + y - t_i$$

The variable  $l_i$  refers to the distance between the preferences of the individual  $i$  and the preferences of his government. The variable  $y$  stands for the individual's income before taxes and  $t_i$  for the taxes he pays. The parameter  $g$  measures what an individual can expect to benefit from internalizing an externality – if his preferences on type of government are the same as those of his government. And the parameter  $a$  measures the loss in utility that an individual suffers when the type of government is far from his preferred type. The key relationship is thus between the two parameters  $g$  – benefits of a public good – and  $a$  – costs of heterogeneity.

<sup>3</sup> The classic lamp-post example was developed by David N. King to illustrate his theory of the optimal size of subcentral authorities (King, 1984).

of government for street lighting is perhaps the city, not the street. Economies of scale in designing street lamps may require a national policy. In short, larger political jurisdictions usually provide public goods more cheaply than smaller jurisdictions because fixed costs can be spread over more taxpayers and because provision over a larger population allows for increasing returns to scale up to some limit (Alesina and Spolaore, 1997). So, all else being equal, a disinterested ruler seeking to provide the best public policy for the least expense will allocate authority to higher levels of government.

But what if individual preferences for public goods are heterogeneous? While people in street *A* may want lamp-posts every 35 feet or more often, those in street *C* or *D* may prefer fewer lamp-posts. The reasons for divergence in preferences may be several. Street *A* may believe that brightness makes streets safer, while streets *C* and *D* may be worried about having lights shining into their houses at night. Or it may be that people in street *A* are willing to pay higher taxes than those in streets *C* and *D*. Whatever the source of heterogeneity, as a general rule, a large population is likely to be less homogeneous than a smaller population. In Alesina's and Spolaore's terms, the average preference distance among individuals regarding the provision of a public good is likely to be positively correlated with the size of the country. People with preferences that differ sufficiently from their government's preferences may on balance wish to have their own government, even if this might mean less efficient government. All else being equal, heterogeneous preferences should induce a ruler to shift authority for a public good to smaller units of government.

The trade-off between economies of scale available to large jurisdictions and heterogeneity of citizen preferences is the core idea of neoclassical theory. Its simplicity makes it amenable to formalization, and this is a task taken up by Alesina and his co-authors (Alesina and Wacziarg, 1998, 1999; Alesina and Spolaore, 1997; Alesina *et al.*, 1995; Besley and Coate, 1999; Bolton and Roland, 1997; Buchanan and Faith, 1987; Casella, 1992; Romer, 2000). In a recent article that succinctly lays out the neoclassical model, Alesina and Spolaore explore the conditions under which secession takes place:

1. The number of countries is greater under democracy than under dictatorship. Dictators do not pay attention to the trade-off between efficiency and heterogeneity, but seek to maximize rents in the form of tax revenues net of expenditures. Given economies of scale in taxation, dictators prefer to have larger countries than justified by maximizing the utilities of citizens. Democratization lowers the barriers to the creation of new countries out of existing ones. If one assumes that any territorially contiguous set of individuals can secede under democracy and that compensation schemes are unwieldy, de-

mocratization will lead to secession of territorial groups with preferences for public policy that clash with those of the median voter in the country as a whole.

2. Such secessions create more countries than is optimal. Extensive government, by virtue of the economic (and political/coercive) benefits it brings, is a public good. However, discrete groups of individuals with distinct preferences may wish to secede even if this makes government less efficient for everyone. While it would be Pareto-improving for the country as a whole to make a side-payment to the seceding minority, Alesina and Spolaore argue that this is difficult, if not impossible, under majority rule. Hence, democratic rules for secession allow territorial minorities to achieve local optima that are suboptimal from the standpoint of the whole population.

3. International economic integration will lead to the creation of more countries because it reduces the economic cost of secession. Conversely, the benefits of forming a large country are less if small countries may freely trade with each other (see also Bolton and Roland, 1997).

The implications that Alesina and Spolaore draw from the neoclassical trade-off between the benefits of scale and the costs of heterogeneity are interesting because they are, at least in part, empirically disconfirmable. We shall return to these below. But, first, it is worth noting that the Alesina-Spolaore model makes a vital simplifying assumption that is not a necessary feature of neoclassical theory. Alesina and Spolaore assume that government is composed of a single public good. This is equivalent to saying that authority for any territory is exclusively located in a single regime – in *a state*, if one uses the term to describe a regime that monopolizes authority in a given territory. When one relaxes the single public good assumption and allows, instead, that governments are responsible for two or more policies, a sharply different picture comes into view.

The question that Alesina and Spolaore ask in their article is, ‘what is the optimum number and size of national states?’. When one admits that governments handle many policies, each with different trade-offs, the national state itself becomes problematic. Instead of inquiring into the optimality of state boundaries, one is led to ask whether states themselves are optimal, and how one may best structure authoritative competencies within and across them. States become a prior constraint, not the solution. This is the radical premise of neoclassical theory.

The logical implication of neoclassical theory is that national states are both too large and too small. Too large, because they encompass heterogeneous populations that are best served by local jurisdictions; too small because they cannot encompass the territorial scope of market exchange or of policies that have international externalities.

This line of thinking draws on the larger literature of fiscal federalism, but it goes further. With respect to decentralization, neoclassical theory follows fiscal federalism in suggesting that public policy should be located at the lowest territorial level of government that is able to encompass relevant economies of scale and externalities (King, 1984; Musgrave, 1959; Oates, 1972, 1999). This is Wallace Oates' decentralization theorem or, in Europe, the principle of subsidiarity, loosely derived from social Catholic thought.<sup>4</sup> However, neoclassical theory pays far more attention than fiscal federalism to the potential benefits of supranational authority. Fiscal federalist literature evaluating the costs and benefits of decentralization in particular states, above all, the United States, Germany and Canada, assumes, for practical purposes, that the state is the institutional container for authoritative competencies. The question for fiscal federalists is, then, how those competencies should be allocated within the state. Neoclassical theory is fiscal federalism without practical inhibitions.

Because it ignores the artificial ceiling of the nation-state, the neoclassical theory of authority is radical indeed. The optimal number of political jurisdictions will approximate the number of government policies if, as is likely in practice, those policies are subject to different economies of scale (and/or if they evoke sufficiently different patterns of citizen preference).<sup>5</sup> This is absolute multi-level governance. The optimal territorial scale for conducting various government functions appears to vary enormously across policy areas. Making war and extracting the resources necessary for doing so has been a distinctly national endeavour. State-building in western Europe is partly – some would argue exclusively – a story of reaping economies of scale in funding and conducting war. Efficient governance for trade seeks to minimize costs of compliance among contracting actors, and will therefore stretch well beyond national states. As the literature on fiscal federalism has taught us, education and health are usually best dealt with at the local or regional level. But the fragmentation of public good provision goes even further. When one disaggregates some policy fields, efficiency demands several levels of government. This is the case, for example in environmental policy, which requires

<sup>4</sup> Fiscal federalists find many virtues in decentralization beyond those given by the neoclassical trade-off between scale and heterogeneity. One of the most important is that decentralized governments have better knowledge of local preferences and cost conditions than central government, and so can respond to changes in preferences or technology more appropriately (Frey and Eichenberger, 1999; Oates, 1999). Another is that local governments can serve as arenas for policy experimentation with less risk than can a central government (Frey and Eichenberger, 1999; Gray, 1973).

<sup>5</sup> A provocative elaboration of this idea has been advanced by Casella (Casella, 1992; Casella and Weingast, 1995; Casella and Frey, 1992; see also Frey and Eichenberger, 1999).

global governance in some areas, such as climate policy, and local governance in others, such as waste disposal.<sup>6</sup>

Two questions arise at this point. First, how robust is the claim that multi-level governance is optimal? Does it rest narrowly on neoclassical assumptions? Can the claim be sustained when one relaxes the most restrictive assumptions of these models to let in more of the real world? Second, what does an answer to this question tell us about the actual allocation of authority in and across particular societies? The territorial allocation of authority varies considerably across time and space in ways that cannot, we believe, be accounted for in terms of optimality. What factors should one pay attention to in order to explain such variations?

### *Transaction Costs*

The neoclassical theory of authority ignores the transaction costs of governance. It assumes that reforming and running government is costless. But once one realizes that the logic of the neoclassical theory is that each government function is optimally carried out in relation to a different set of citizens, one can no longer set aside the negative externalities of multiple governments.

The proliferation of governments is constrained by decisional, informational and infrastructural costs.

*Decisional costs.* To the extent that multiple governments have overlapping competencies, so each government may impose costs on others. This lays the basis for what Fritz Scharpf has called the 'joint decision trap' (Scharpf, 1988). One possible solution to decisional blockage is to reduce the scope of overlapping competencies by compartmentalizing policy so that each government is solely responsible for a particular policy. But this can never be completely achieved because different policies are always connected to some degree.

*Informational costs.* Increasing the number of governments increases the costs of information for both citizens and rulers. Citizens are confronted with a system of governance that is difficult to comprehend. Groups wishing to

<sup>6</sup> The literature of fiscal federalism is not concerned only with the optimal allocation of policies among levels of government, but examines how functions and fiscal responsibilities can be *shared* among levels of governments in a federal system. Indeed, greater complexity of policy functions and interdependence of policies make it unrealistic to expect policies to be allocated in exclusive packages. The notion that compartmentalization is inefficient underlies the thinking of scholars concerned with efficient governance in the European Union. Scharpf has sought to stipulate the optimal mix of national (or subnational) and EU problem-solving capacity for a range of policies. Scharpf demonstrates that the optimal division of labour between subnational, national and European levels varies by policy area, and each arrangement involves some sharing of responsibilities among the European Union and national (or subnational) governments (Scharpf, 1999). In their work on regional policy, Benz and Eberlein (1999) illustrate how an array of practical arrangements can enhance the efficiency of multi-level governance.

predict or influence future laws will have to learn their way around a labyrinthine political system. The proliferation of governments also makes it more expensive for policy-makers to gain information about the constituents of a particular policy. To the extent that policy constituencies are the same, so policy-makers can take advantage of economies of scale in gaining information about them.

*Infrastructural costs.* Governments that are responsible for a wider range of functions are more able to take advantage of economies of scale in their provision. This line of argument should not be confused with the point that territorially extensive governments can better exploit economies of scale in providing public goods, such as security and trade. The infrastructural cost of government depends not on its territorial extensiveness, but on economies of scale in making, adjudicating and implementing law. As the sheer number of governments proliferates (at whatever territorial level), their size, and hence their efficiency, declines.

The advantage of overlapping territorial jurisdictions is that different government functions can be tailored to different constituencies. But the informational, decisional and infrastructural costs of such a set-up are likely to be high. This may explain why systems of multi-level governance are generally nested, that is, lower levels of government are completely encompassed by higher levels of government.<sup>7</sup>

Transaction costs also constrain the number of levels of government. Neoclassical theory demands about as many levels of government as the number of government policies. If  $n$  policies have  $n$  different optimal trade-offs between efficiency and heterogeneity, then neoclassical theory argues that there should be  $n$  levels of government. A transaction cost account, in contrast, asks whether the marginal benefits of an additional layer of government justify the additional decisional, informational and infrastructural costs that it incurs. The closer that existing levels of government are together, the smaller the benefits of adding an additional level. Hence, the benefits of additional levels are a declining function of the number of levels.

This provides a basis for theorizing path-dependent dynamics.<sup>8</sup> Once a level of government is established, it may become a magnet for additional authoritative competencies – even if this is not optimal from a neoclassical

<sup>7</sup> There are some exceptions. The formal structure of subnational government in Europe remains nested, though cross-border associations of regional governments have mushroomed over the past decade. However, they exercise little real authority. More far-reaching developments appear to be taking place in the United States. One of the most notable developments there has been the rise of so-called 'special districts', a type of local government devoted to the provision of a single public good – such as schools, roads, water and electricity – and defined over an area independent of traditional jurisdictional borders. By the mid-1990s, there were almost twice as many special districts as towns (Casella and Weingast, 1995).

<sup>8</sup> On path dependency, see Pierson (2000).

standpoint. Path dependency arises because the transaction costs of allocating an additional competence to an existing level of government are usually less than the costs of establishing a new government.

Might not the costs of government proliferation outweigh the benefits of multi-level governance? This depends on the benefits of flexibility in relation to the costs of proliferation. The factors we have discussed constrain authority in different ways. Economies of scale push government up to larger jurisdictions; heterogeneity presses government down to smaller jurisdictions; transaction costs constrain the number of levels of government. The greater the variation in the territorial scope of optimal governance across policy areas resulting from the trade-off between efficiency and heterogeneity, the greater are the benefits of multi-level governance. Given the very wide variations in this trade-off across policy areas, transaction costs would have to be massive to outweigh the benefits of multi-level governance.

### III. Towards a Causal Theory of Authority

The neoclassical theory of authority allows one to think through the optimal territorial allocation of government. It is a prescriptive theory that implies the superiority of what scholars of European integration describe as multi-level governance. This convergence is all the more interesting because neoclassical theory and the study of multi-level governance have been entirely independent endeavours.<sup>9</sup>

The optimal articulation of authority, however, is likely to be a poor predictor of the actual articulation of authority. What steps does one need to take in order to build a causal theory of authority? One step, which we suggest above, is to amend neoclassical theory to include transaction costs. In this section we argue for more radical surgery. First, one needs to theorize how ideology, broadly defined, influences human behaviour. We follow Douglass North in proposing that the 'mind sets' of individuals shape the way they process incentives and disincentives of institutions (North, 1990, 1997). Second, we theorize that government leaders have private preferences that lead them to devalue the kinds of solutions that a disinterested social planner would choose. Third, we argue that one must go beyond the distribution of individual

<sup>9</sup> Neoclassical scholars have only recently begun to apply their insights to the European Union (Alesina and Wacziarg, 1999). Students of public finance and fiscal federalism began studying the diffusion of authority in the EU in the 1990s (Bureau and Champsaur, 1992; Casella, 1992; Casella and Weingast, 1995; Casella and Frey, 1992; Inman and Rubinfeld, 1992; Weingast 1995; Frey and Eichenberger 1999). There appears to be little cross-fertilization between this literature and the study of governance in the European Union. An exception is an article by Casella and Frey (1992), in which the authors acknowledge that their concept of 'functional federalism' is similar to Schmitter's notion of 'condominio'. For a succinct discussion of the contribution of fiscal federalism to theorizing regional integration, see Mattli (1999, pp. 38–40).

citizen preferences if one wishes to explain actual political outcomes. The heterogeneity of citizen preferences determines outcomes only if it is expressed in political coalitions. A theory of coalitions must, therefore, underpin a causal explanation of authority.

### *Ideology*

Neoclassical assumptions about human behaviour are highly restrictive and unrealistic when applied to choice concerning authoritative institutions. They need, we argue, to be replaced with a theory of human behaviour that engages how actors comprehend the options open to them.

Let us take this step by step, and examine first the neoclassical position. The neoclassical theory of authority borrows its basic assumptions about individual choice from neoclassical economics. The theory generates unique predictions about behaviour by positing that actors seek to maximize their utility under given constraints. This involves the following assumptions:

1. The consequences of an individual's choice for his or her utility are transparent. Individuals know what the consequences of different choices are, and they can clearly differentiate among them.
2. Individuals are distinguished only by their preferences. That is to say, any actor with a given set of preferences would make the same choice.
3. Poor (i.e. non-maximizing) choices are weeded out. Poor choices are inexorably and repeatedly punished, for example, by diminishing the portfolios of bad investors or eliminating non-adaptive states in war.

One should bear in mind that these assumptions are not intended to be an accurate representation of the world. They are designed as simplifications to facilitate formal analysis. While they have yielded powerful explanations in many areas of human choice, we believe they straitjacket the study of authority.

First, the consequences of alternative authoritative institutions are ambiguous and contested. One reason for this is that individual actors have only partial information about the preferences of all other citizens, and so cannot predict the policies of an alternative jurisdiction with any certainty. But the issue goes beyond incomplete information.

Even if complete information about preferences were available, disagreements about efficiency would arise. One compelling illustration of this is that scholars of fiscal federalism disagree about how much decentralization is good, depending on their evaluation of decentralized policy experimentation and policy learning ('laboratory federalism') (Gray, 1973; Rogers, 1983); interjurisdictional competition (Break, 1967; Oates and Schwab, 1988; Scharpf, 1999); decentralized political participation (Frey and Eichenberger, 1999; Inman and Rubinfeld, 1997); the link between decentralization and economic growth (Weingast, 1995; McKinnon, 1997; Bahl and Linn, 1992); principal–

agent problems (Shah, 1998), including, in particular, government rent-seeking (Brennan and Buchanan, 1980; Frey and Eichenberger, 1999).

Differing conceptions of efficiency can be narrowed, but not resolved, empirically. They reflect basic ideological conflicts in society, including contention about communal identities and contention about the proper role of government. The notion that efficiency uniquely determines choice is undermined if political actors have incomplete information or have ideological commitments that shape their conception of the means best suited to achieve given ends.

Mental schemas cannot be reduced to the familiar neoclassical conception of heterogeneity of preferences if those schemas affect not only the policy goals actors have, but the institutions that appear most promising in achieving them. The theoretical consequence of this is fundamental: actors having identical preferences may not make identical choices. The basic postulate of neoclassical theory does not hold; actors with identical preferences are *not* interchangeable.

Finally, the feedback mechanisms at work here appear far too weak to weed out non-maximizing choice.<sup>10</sup> Institutional reform of territorial allocation of authority is unusual, and so there is little possibility for Pavlovian conditioning or learning by experience. Scarcity and competition, which create powerful incentives for rational behaviour in neoclassical economic theory, are weak or non-existent in authoritative reform. Those who choose irrationally are not necessarily punished, while those who are rational may not be rewarded. The signals that individual citizens receive on their utility radar screens from reform of territorial jurisdictions are infrequent and indistinct.

These criticisms point in one direction. In place of neoclassical behavioural assumptions, we believe that a theory of authority must engage the ideologies that individuals use to decipher the environment (North, 1997, p. 3; KLMS, 1999a; Marks and Wilson, 2000). Ideologies are 'economizing devices for receiving and interpreting information' (North, 1997, p. 13). They are likely to be most firmly rooted in situations where no uniquely efficient solution can be identified and where, as a result, there are genuine disagreements about ends and means that are not whittled away by experience.

Which ideologies shape views on territorial allocation of authority? Preferences concerning the allocation of authority often express communal identities and the demand that distinct territorial communities – nations, or more generally, tribes – exercise self-determination. Communal loyalties based on some combination of ethnicity, culture and language, have been enormously powerful in bonding human beings into larger groups. Over the past two centuries, nationalism has underpinned the idea that authority is indivisible,

<sup>10</sup> For a general discussion of path dependence, see Pierson (2000).

that the centralized state is a 'natural' expression of national community. Nationalism has been an immensely powerful force against multi-level governance.

Nationalism remains powerful in structuring views about the territorial articulation of authority. Party support for further European integration declines sharply as a party is located near the traditional/authoritarian/nationalist pole of the 'new politics' dimension of contestation in Europe (Hooghe *et al.*, 2000). Political parties that describe themselves as nationalist, such as the French Front National and the Flemish Vlaams Blok, tend to be fiercely anti-EU, while conservative parties with a strong national outlook, such as the British Conservative party and the French Gaullists, are among the most Eurosceptical of the mainstream parties.

The left/right dimension of contestation, which is salient in all advanced capitalist societies, has also engendered conflict about the territorial articulation of authority. Those on the left, supporting economic equality and government regulation of the economy, have generally campaigned for strong national states capable of economy-wide regulation and redistribution. Once strong national states were in place, the left came to believe that the fate of social democracy rested with the state. However, as economic internationalization has intensified, many social democrats have re-evaluated their prior attachment to national institutions and now argue that the best way to regulate capitalism is by building supranational authoritative institutions that can more effectively encompass the territorial scope of market exchange. Those on the right, who prioritize individual economic freedom and market competition, generally oppose supranational authoritative institutions that do more than reduce economic transaction costs. Left–right contestation has structured debate on European integration (Hooghe and Marks, 1999), and it is a recurring feature of debates about the competencies of international regimes, such as the World Trade Organization or the North American Free Trade Agreement (Marks and Down, 2000). Because the territorial allocation of authority bears on the distribution of values, authoritative reform often involves ideological conflict.

### *Rulers' Private Preferences*

Rulers, that is, government leaders, have a private preference to maintain their position in authority, and this may shape the territorial articulation of authority. Authority is unlike all other goods because it increases the potential to achieve future goals.<sup>11</sup> Whatever substantive goals a person has, it is likely that

<sup>11</sup> Parsons (1968, p. 263) and Mann (1986, p. 6) make this point with respect to power. The same logic holds for authority, which we define as legitimate power.

political authority, the capacity to exercise legitimate power over other individuals, will help to realize them.<sup>12</sup>

This position takes issue with the neoclassical theory of authority, which assumes that rulers wish to maximize their income, i.e. the rents they are able to squeeze from those they govern (Brennan and Buchanan, 1980; Buchanan and Faith, 1987; see also Olson, 1993).<sup>13</sup> The difference reflects the epistemological contrast between economics and political science, and is usually considered to be part of the irrefutable 'hard core' of these disciplines. But the conception of rulers' motives is a central element in a theory of authority, and has empirically falsifiable implications.

Take the Alesina and Spolaore argument that dictators are unwilling to allow minorities in their countries to separate because they wish to maximize rent, i.e. tax revenues net of expenditures. As with many plausible alternative theories, the predictions of this theory and the one we propose overlap. Both theories predict that most dictatorships will oppose most separatist movements. But the threshold for dictatorial consent to secession under a rent-seeking assumption is lower than under an authority-seeking assumption.

If dictators were rent-seekers they would grant independence to a separatist movement if they believed that the costs of defeating it exceeded the potential revenue benefits of the disputed territory. Under the authority-seeking hypothesis, by contrast, rulers are unwilling to allow secession even if repression costs the government more money than could ever be recouped by taxing the disputed territory. Rulers will allow secession only if, on balance, it strengthens their hold on authority. Authority-seeking rulers worry about their credibility as defenders of the nation, and fear that their legitimacy will be undermined if they allow secession. Also, if a ruler has a personal ideological commitment to the unity of the national state, this will affect the way he processes the costs and benefits of repression.

Unfortunately for minorities in many parts of the world, rulers appear to be driven by their preference for authority rather than their preference for rents. Many secessionist movements are repressed even though the fiscal costs of doing so clearly outweigh the fiscal benefits.<sup>14</sup> Wars of Pakistan against the

<sup>12</sup> An obvious exception is if a ruler wishes to live a quiet life, and this leads him to retire (though, as King Lear found, divesting oneself of authority may be a perilous affair). Another source of possible contradiction between a ruler's substantive goals and the desire to remain in authority may occur when a ruler is committed to a manifestly unpopular policy. For an empirical examination of this possibility in a democratic setting, see Steiner (1996).

<sup>13</sup> There are some variations. For example, Alesina and Spolaore assume that only dictators act as rent-seekers. The private preferences of democratic rulers are irrelevant in their model because policy is assumed to follow the preferences of the median voter (1997, p. 1031).

<sup>14</sup> There are many ways in which the rent-seeking hypothesis could be elaborated to survive such cases. For example, rulers might be imperfectly informed about the potential costs and benefits of repression (in ways that would lead them to underestimate the costs or overestimate the benefits), or they might evaluate the trade-off in terms of their personal economic fortunes, not those of the state.

secession of Bangladesh, of Ethiopia against Eritrea, Indonesia against East Timor, or Russia against Chechnya are examples. It is difficult to imagine that rulers in such cases are motivated by rent-seeking or fiscal incentives, even if one were to make the (unrealistic) assumption that they take the long view and discount immediate and very steep costs of repression on the expectation of future rents.

In pursuing their private preference for authority, rulers are constrained by the rules of the game and by their ideologies. Hence, rulers' strategies vary across time and space. In order to retain authority, dictators, past and present, give the impression that they are impregnable. There is a tipping phenomenon here: if a dictator is perceived to be vulnerable, opposition that formerly lurked in the shadows may reveal itself in the open. As fear of repression is lifted, the task of repression is magnified by previously pent-up opposition (Schmitter and O'Donnell, 1986).

A democratic setting demands different strategies. If a democratic ruler wishes to sustain her tenure in office, she must win elections, not centralize authority in her own hands. This, we hypothesize, is the reason why multi-level governance is so much more common in democracies than in autocracies. Whereas the logic of autocracy is to centralize authority, democracy is open with respect to the territorial allocation of authority. A ruler who competes to win the support of nationalists may centralize authority at the national level, while one who promises prosperity may be led to diffuse authority. In European political development, democratic rulers have tended to centralize authority in time of war and diffuse authority in time of peace, particularly during the unusual and sustained peace of the second half of the twentieth century.

Democratic rulers respond to voters in reforming authoritative institutions, but they do not act simply as transmission belts. We have argued above that the fit between preferences for policy and authoritative institutions is likely to be loose. So the notion that the median voter determines outcomes, while elegant, does not provide theoretical space for the reality of contending interpretations of the costs and benefits of alternative jurisdictional arrangements (e.g. Alesina and Spolaore, 1997; Romer, 2000). We concluded above that ideologies frame contestation about authoritative institutions. In a democratic setting, rulers compete for support by framing appeals that reflect their evaluative/cognitive mindsets or ideologies.

### *Coalitions*

We have examined the inadequacy of efficiency as a guide to jurisdictional outcomes, and we have suggested that ideology and rulers' private preferences

may provide a more sound basis for a theory of territorial allocation of authority. In this section we take up the other foundation of neoclassical theory – heterogeneity of preferences – and make the case for a more causally proximate approach that investigates the variables that intervene between individual preferences and the efforts of rulers to build winning coalitions.

Rulers rarely need to be responsive to all citizens equally if they want to retain their position in authority. In neoclassical theory, citizen preferences across public policy outputs along with efficiency considerations determine the optimal allocation of authority. But we submit that this tells one little about how authority is allocated in practice. To explain institutional change, one must take into account the capacity of citizens to realize their preferences, and this demands that one pay serious attention to coalitional politics. Many citizens are not organized and have little influence on outcomes, while others have considerable influence. Coalitions can be understood as preferences weighted by power. Coalitions are, in other words, the *political* expression of the heterogeneity of citizen preferences. Not only can we observe coalitions with greater precision than we can observe citizen preferences, but they are an important step closer along the causal chain to the phenomenon – the territorial allocation of authority – that we wish to explain.

Coalitional analysis, therefore, needs to underpin a theory of authority. We have four general observations. First, it makes little sense to analyse coalitions as efficient mechanisms for rulers to secure authority. If rulers used coalitions in this way, why would coalitions support them? The force of this question is all the greater if the ruler is difficult to unseat once in office. A ruler who operated as a rational actor in seeking coalitional support would have trouble convincing others that she would carry out her promises if she came to office (Downs, 1957; Hinich and Munger, 1994). This leads us to suggest that ideology is important in understanding political coalitions. It links rulers to the groups that support them. By assuring supporters that a ruler will actually carry out her campaign promises, ideology can provide a measure of predictability under incomplete contracting.

Second, coalitions do not usually have intrinsic preferences for particular allocations of authority.<sup>15</sup> Instead, they have preferences that *imply* a particular allocation of authority in a particular historical context. For example, traders typically seek institutions that can enforce compliance to norms facilitating economic exchange across the relevant trading area. In post-World War II Europe, this has led them to support international and regional economic integration. Multinational corporations and mobile capital have

<sup>15</sup> A preference for nationalism, which intrinsically involves the concentration of authority at the national level and opposition to supranationalism or subnational regionalism, is an important exception, as discussed above.

been powerful forces behind European integration over the past half century. In late feudal times, however, the same preference led traders to support the centralization of authority in national states, as Spruyt observes (1994). Monarchs who monopolized authority in national states could institute standard weights and measures, a single currency, uniform taxation and a rational judicial system. Spruyt goes on to explain variation in regime type – city-states in northern Italy, the national state in France and England, and the city-league in central and northern Europe – as a consequence of the coalitions available to rulers.

Third, the logic of coalition-building reflects the authoritative rules in a society. In parliamentary democracies, the most important coalition partners are political parties. Political parties design electoral appeals in order to win votes and office, but they are constrained by ideologies that are rooted in programmatic commitments and long-standing ties to particular organized groups (Lipset and Rokkan, 1967).<sup>16</sup> In presidential systems, like that of the United States, political parties are less important in structuring political choice and are less able to insulate rulers from organized interests. A pluralist model, in which policy is a vector outcome of group demands, is far more appropriate for American politics than it is for European politics (see, e.g., Besley and Coate, 1999; Romer, 2000).

Finally, reform in the allocation of authority rarely reflects the preferences of the median voter. The median voter has an alluring simplicity for formal modelling (cf. Alesina and Spolaore, 1997; Romer, 2000), but it is singularly inappropriate for explaining reallocation of authority. Such reforms often have the status of constitutional decisions, and are therefore subject to special decision-making hurdles – including some combination of legislative supermajorities, referendums, subnational veto and constitutional court review. At the extreme, unanimous consent among participating governments may be a necessary precondition for major institutional reform, as in the EU. Supermajorities, across multiple political arenas, are the norm rather than the exception.

#### IV. Conclusion

The neoclassical theory of authority probes the tension between the scale advantages of large jurisdictions and the spatial heterogeneity of individual

<sup>16</sup>The influence of ideology is greatest where the feedback mechanism of electoral performance in relation to a particular policy is weakest. Hence, when information about the positioning of voters is incomplete or when voters have weak preferences for a particular policy, political parties are most likely to determine their position on that policy in the light of their established ideologies without attention to competitive pressures. This approach parallels that of North, except that the trade-off in question is between ideology and tenure in authority, rather than between ideology and income (North, 1990).

preferences. This tension lies at the heart of governance, and neoclassical theorists have built elegant and general models around this insight. Whereas the literature on multi-level governance in the EU is mainly descriptive, neoclassical theory is self-consciously abstract and generalizing.

The implications of neoclassical theory for the allocation of authority are radical. In order to capture the benefits of scale and of taste heterogeneity, neoclassical theory proposes an extreme form of multi-level governance and, in some accounts, infinitely overlapping jurisdictions. Nothing could be further from the notion that centralized states are the optimal way of organizing political life. Neoclassical theory is a breath of fresh air for those who have argued that national states are being undermined in the course of European integration.

Whatever its failings, this article has not, however, erred by being overly deferential to neoclassical theory. It is guided by the conviction that government structure cannot be explained as a functional response to environmental challenges. Our aim, in short, is to bring politics into the study of institutional choice. By importing rational actor assumptions from economics, the neoclassical theory of authority produces elegant formal models. But how appropriate are these assumptions for the explanation of government jurisdiction? Efficiency, we have argued, is ambiguous, feedback mechanisms punishing sub-optimality are relatively weak, individual utility maximization does not lead to uniquely rational behaviour, and transaction costs need to be taken into account. For each of these reasons, the optimal articulation of authority is likely to be a poor guide in explaining the actual articulation of authority. A more promising approach, we suggest, is to recognize that individual choice with respect to territorial authority is shaped by ideology, that rulers have a private preference in sustaining themselves in authority, and that reform of authority is contested by political coalitions. To pay attention to these factors is to place politics – contestation about the good society – at the centre of a theory of authoritative allocation.

The proof of this approach lies in its explanatory leverage relative to that of the neoclassical theory. Both theories will need to operationalize variables, and assess their causal power in rigorous empirical analysis. Empirical specification is, perhaps, the real challenge for a causal theory of authority. The effort to meet it can build on recent work in federalism/regionalism, international political economy, and European studies.

*Correspondence:*

Gary Marks  
 Department of Political Science  
 University of North Carolina at  
 Chapel Hill  
 Chapel Hill, NC 29599-3265  
 email: marks@unc.edu

Liesbet Hooghe  
 Department of Political Science  
 University of North Carolina at  
 Chapel Hill  
 Chapel Hill, NC 29599-3265  
 email: hooghe@unc.edu

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