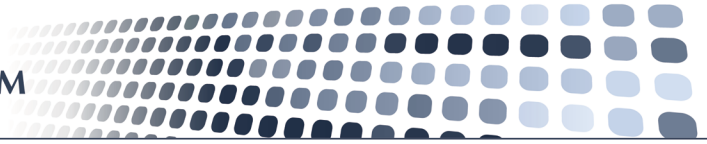




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**Economic Epistemology and Methodological
Nationalism:
a Federalist Perspective**

by

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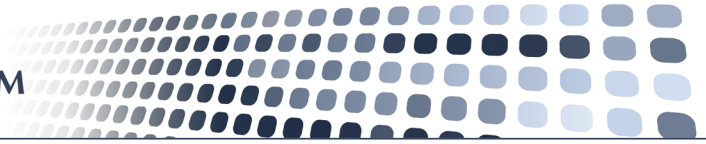
Abstract

Economics is based on the assumption that the only administrative and juridical relevant framework of both theory and policy is the nation-State.

We claim that such methodological nationalism is detrimental to the capacity to understand the operation of economic relations and to effectively achieve economic policy goals. The high interdependence worldwide of economic relations calls for a multi-layer perspective of both analysis and governance in economics, where the constitutional principles of federalism may play a significant role.

Key-words:

Economic theory, economic policy, methodological nationalism, multi-layer governance, constitutional federalism.



Introduction

Is economics immune from the evils caused by what the sociologist Ulrich Beck (1999) called *methodological nationalism*, meaning that the only juridical framework implicitly or explicitly assumed in social sciences is the *absolute* and *exclusive sovereignty* of the nation-State?

The goal of this short note is to provide some hints to cope with such a question and suggest the need for a collective effort and a wide scientific discussion aiming at a reconsideration of the epistemological and ontological foundations of economic science.

In order to accomplish this task, we first need to address some crucial problems. The first is: why should a juridical and political concept such as *sovereignty* be important in economics? The second: is there any existing intellectual guidance for the reformulation of the epistemological foundations of economics which may allow us to overcome the flaws, if any, brought about by methodological nationalism?

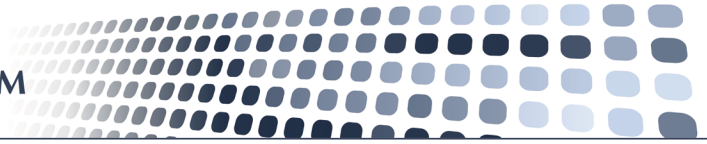
We will deal with the former question in the first section, where the concept of sovereignty in economics will be observed through the lens of methodological nationalism. The following section will be devoted to considering some literature which might be of help in facing the theoretical and normative challenges posed by methodological nationalism, with a particular consideration of constitutional federalism. The third section suggests some epistemological and ontological reconsideration of economics. Section four tackles with the importance and shortcomings of multi-level governance and functional governments. The final section offers some conclusions.

1. Economic Theory, Economic Policy, and Methodological Nationalism

Both economic analysis and economic policy normally assume a unique level of legitimate authority in economic matters: the nation-State.

Those sections of the economic thought which do not assume this explicitly, do so implicitly. Only some minor, marginalized contributions to economic theory abandon this assumption.

Most economic models are (or pretend to be) a-political, in the sense that they are intended to be independent of political and administrative jurisdictions. The



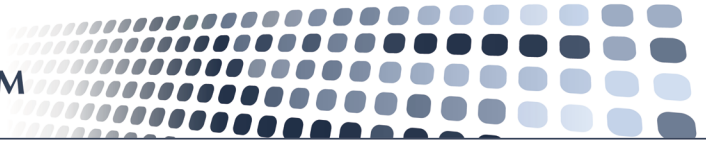
microeconomic foundations of economics are based on the behaviour of individual subjects – both human beings and firms – with their maximization functions, in most cases irrespective of the institutional context where choices are made. The ontological framework of microeconomics is mainly constituted by social atomism, where each individual chooses among alternative consumption patterns according to his own preferences and exogenous constraints. Institutional administrative structures play no role in this process.

As concerns macroeconomics, it was born and finds its epistemological foundations in the attempt to shift the economic system of a nation towards the goals set by its government. At least in a Keynesian perspective, it is therefore methodologically nationalist in principle, as the only sovereign economic powers are assumed to be the national ones. Open macroeconomic models should not be considered outside this logic: even international cooperation games are only an attempt to analyse from the national perspective certain international phenomena characterized by high and increasing interdependence.

Interdependencies among national systems, that is externalities on national choices generated by the behaviour of a foreign individual or national entity, are obviously acknowledged but only aiming at making them as exogenous as possible in both analysis and policy-making.

Unfortunately, this attitude leads to major positive and normative shortcomings, as the very nature of interdependencies can and should be analyzed only by making them endogenous in a wider system of observation and action. The constraints upon single national economic policies should be managed so as to analyse and decide which is the appropriate level and under which conditions a specific economic policy can become effective. Economic policy is therefore the discipline where methodological nationalism most affects the effectiveness of normative economics and where its evils are most evident.

The traditional approach to economic policy based on the use of specific (national) tools to achieve (national) goals is meaningless in the context of enormous interdependence and externalities which characterize today's economic systems and relations. The national authorities of economic policy are incapable of tackling problems whose control lies outside their realm. They are therefore equipped only with ineffective tools to face challenges which imply global strategies.



2. Multi-Level Constitutions and Economic Federalism

The questions are now: a) is there any specific approach to economic theory and policy which can help overcome the flaws we have underlined concerning methodological nationalism; b) has there been any conscious attempt to recognize the negative effects it made to economics? For both questions the answer is: yes, there are.

In politics, a constitutional principle which explicitly tries to overcome the exclusiveness of national sovereignties is federalism. Based on historical experiences such as the USA Philadelphia Convention of 1787, federalism recognizes some guiding constitutional principles for an effective multilevel system of government.

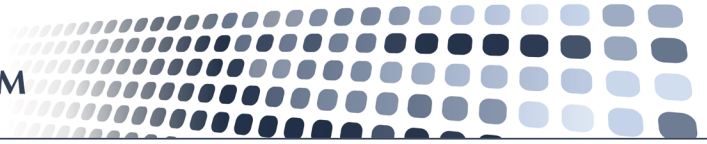
The constitutional principles of federalism have managed to surface in economic thought in two very different ways.

The first is well known and is part of mainstream economics: *fiscal federalism*. Its aim is to establish whether certain budget competences should be attributed to sub-national bodies.

The second is a neglected and even marginalized contribution to economic theory and might be labelled as *international federalism*, according to which some internationally shared public goods, such as peace (conflict resolution), monetary stability, etc should be provided by some supranational legitimate body (as suggested for example by Luigi Einaudi, Lionel Robbins, Robert Triffin). Both challenge the exclusive sovereignty of the nation-State, although in different, separate directions.

These two approaches to the use of constitutional federalism in the realm of economic relations have never communicated with each other.. Although they cannot be accused of methodological nationalism *stricto sensu*, as they both intrinsically aim at overcoming it, they nevertheless face and challenge only one of the two sides on which methodological nationalism is founded.

Why should the logical consequences of fiscal federalism stop at the level of national federations? And why should constitutional federalism claim that the legitimate governing body which can surrender its exclusive sovereignty should only look upwards and not also downwards?



The challenge ahead is to overcome this asymmetrical behaviour and attempt a sort of epistemological reconstruction of economic theory and policy based on some kind of *integral federalism*.

In the perspective of such integral federalism, economics should be founded on concentric levels of choice and on sets of concentric institutions which allow those choices to be made effectively.

Vito Tanzi (2008) has recently attempted exactly this when suggesting that the models applied to fiscal federalism should be also valid when designing the provision of global, supranational public goods. He has concluded his study on *The Future of Fiscal Federalism* underlining “two large gaps in the fiscal federalism literature: the link of prevailing views on fiscal federalism to historical development; and the de facto on-going, step by step creation of a layer of government, or a power, above that of national governments. We have been spending too much time looking down from the central government’s layer. It is time to look up from that layer” (Tanzi 2008: 710).

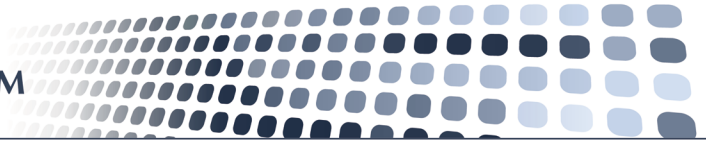
The literature on collective public goods concerning supra-national collectivities is also relevant in this context: European public goods such as transport and communication infrastructures, research, etc suggest the need to reshape the economic governance of the European Union according to a multi-layer perspective. Some academic articles concerning the provision of global public goods point in the same direction, stressing the need to design at least a double-layer institutional arrangement worldwide where genuine and enforceable global institutions tackle global problems along with national governments.

In other research fields like the literature on multilevel governance, on subsidiarity, on “fiscal competition” (Oates 2001), on “functional overlapping and competing jurisdictions” (Frey and Eichenberger 1999) other relevant suggestions are raised concerning the question of multi-layer economic government.

Nevertheless, unfortunately, no comprehensive attempt to put all this together in a coherent whole has yet been made¹.

3. Economic epistemology: a suggested path

In the bottom-up perspective of the principle of subsidiarity, let us first consider single human beings. Let us further consider a condition where the individual is isolated



from others as Robinson Crusoe was. In such a case, he is called to satisfy most of his needs by himself. This might be time consuming but he has no better alternative.

When Friday comes in, both he and Robinson Crusoe can satisfy more needs than those which each of them could satisfy alone. They can specialize in what they can do best and exchange the products of their respective work. They can even join in some common tasks, such as that of providing some degree of security against dangerous animals.

If the community increases, it is likely that the provision of collective goods will be easier and more efficient, as well as the satisfaction of each individual's needs. Furthermore, they now have a greater market where they can exchange the products of their highly specialized work.

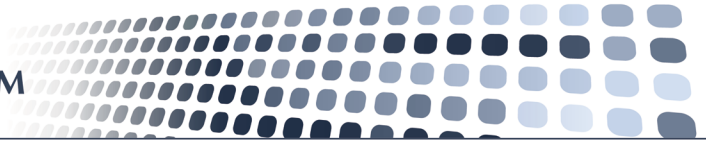
The group can then become bigger and bigger, until the operation of the market and the provision of certain basic collective goods might become difficult to attain. Contracts might become hard to enforce and collective choices might not be unanimously shared. The community must work out and agree on a decision making process which allows collective choices to be taken and institutional arrangements be designed to guarantee the operation of the market. This is where politics comes in.

The birth of nation-States can be considered a further step in this process. Given a framework of potential conflict (peace is the most difficult global public good to provide), the defence of territories and of people requires the maximum effort of the community. Hence the pact whereby the State exchanges citizens' security and other fundamental public goods with military service and taxes.

During the XIX century, the State becomes the only institutional framework where collective public goods are provided. It is exactly at this stage of history, which coincides with the formation of an autonomous status for social sciences, that methodological nationalism is born and grows stronger.

In the first decades since the birth of social science, this was not a "disease" in Beck's terms. It actually helped both the consolidation of the nation-State, providing intellectual legitimacy to its political-cultural consolidation and to the provision of national-collective public goods.

But history has proved that nation-States have been only a step in the evolution of the production of collective public goods, in the satisfaction of shared human needs. Interdependence has grown in economic (as well as political, social, cultural) relations.



Interdependence weakens the capability of monolithic absolute and exclusive sovereign States to achieve the objectives which come out of a national decision making process. Interdependence implies potential conflict and a systematic effort to escape problems of collective action at a supranational level. Hence the attempts for *decentralization* on one side (within States), *coordination* and *governance* on the other (outside and among States).

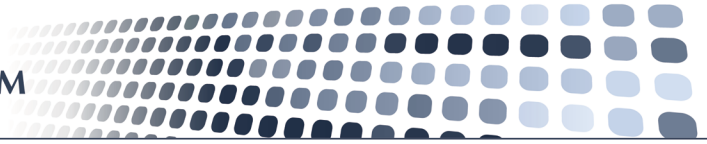
But the key point is that such attempts represent the highest symbols of economic nationalism, not their overcome. They imply the recognition that the only legitimate powers are nation-States which are mandated by their peoples to allocate parts of their duties to local authorities or to negotiate the best possible arrangements for the sake of alleged national interests at an international level.

This is where the concept of sovereignty comes in and appears in all its importance for economics. As we have previously underlined, this analysis leads to one of the two following scenarios: a) global public goods are underprovided due to collective action problems deriving from a decision-making process based on the veto right; b) they are provided according to the logic of diplomatic negotiations managed with the rule of strength, which is the only enforceable rule when no juridical framework exists. The alternative, within the so-called “cooperative” scenario, is only between the defence of the status quo and the dominance/hegemony of a (political, economic and military) power in international relations.

4. Multi-Level Governance and Functional Governments

An example of this can be observed in the most recent and refined version of the theory of international cooperation: the concept of multilevel economic governance (MLG). MLG is a way to solve the difficult task of making collective choices in a diplomatic, non-enforceable setting.

Negotiation is the key to MLG decision-making. As such, it is subject to the laws of negotiating strength, not to the enforceable rules of a higher sovereign juridical order. Furthermore, decisions in such contexts are quite often made according to the unanimity rule, which certainly allows for the maintenance of Pareto optimality but can hardly be used to make effective decisions^{II}.



What is needed is to move from a weak Multi-Level-Governance to a system where the decision making process is given by democratic legitimacy and is made under the rule of a constitutional law.

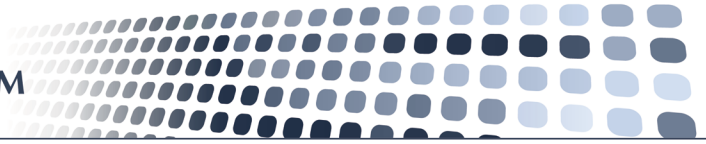
This is where methodological nationalism should be abandoned. Absolute and exclusive national sovereignties imply the intrinsic impossibility to share the responsibility of choices with individuals belonging to a *different* area of national absolute and exclusive sovereignty. True cooperation is therefore impossible, where by *true cooperation* is meant not just a process *attempting* to achieve a collective choice but a constitutionally ruled mechanism *bound to* attain a collective decision.

For this reason the provocative suggestion by Frey and Eichenberger is attractive: it implies that for each function (collective public good) a specific decision-making process should be assigned where all those who are affected by its choices can take part in the decisions.

The problem with this suggestion is that democratic assemblies would become virtually infinite, so as to enormously increase the transaction costs implied in each decision-making process.

Is there any better way to solve this problem, without incurring the risk of such flaws? The difficulty lies in the need to overcome the dichotomy between “structure” and “system” suggested by Bertalanffy (1968)^{III}. The *economic policy* question is in fact how to *reconcile* a democratically legitimised decision making process which implies some kind of simple bottom-up multi-layer *institutional structure* with an *economic system* characterized by strong interdependencies among all layers. Furthermore, which competences should be assigned to each level of the multi-layer governing architecture?

At the same time, there is a *theoretical question* requiring the search and definition for new economic categories, trying to substitute those which appear to be too much linked to the context of methodological nationalism from which they sprang. Is the Ricardian theory of comparative advantage of any help in a multi-layer world where no clear-cut *in* and *out* national borders exist? Are the present theories of exchange rates and monetary policy-making sufficient to analyse and manage a highly interdependent world? Is the concept of externality as we know it a still viable economic category if we recognize that most economic phenomena have external effects?^{IV} These are some of the points upon which further reflection is needed and a debate should be opened.



Concluding remarks

Intellectual cross-fertilization is often viewed with scepticism by some academics. But economics, as a social science, crucially depends on the institutional framework where economic relations take place and economic agents act. Economics is therefore inherently intertwined (at least) with law, politics, and sociology.

The increasing interdependence of economic facts and acts worldwide makes it even more important to abandon ineffective cultural habits like methodological nationalism - which no longer helps read and change economic relations - and suggests the need to make an effort of creativity to design a more effective system of analysis and policy in economic matters, more coherent with the multi-layer, complex dimension of challenges. Federalism can give an important contribution to this. An effort to overcome the flaws of partial approaches to multi level governance and single-sided federalism may give a fundamental hint for a more coherent relationship between economics and the framework where its forces express themselves.

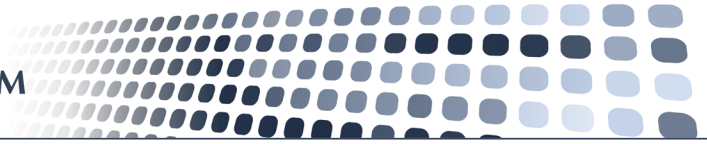
Multi-Level Governance and, in particular, *Functional Overlapping and Competing Jurisdictions* both provide an interesting base for a more effective approach to the way economic relations should be observed and decisions taken. But they should be coupled with the legitimated and existing structure of institutional public authorities, so that a cost-minimizing decision-making system can be designed and realistically implemented for the provision of concentric collective goods, from the local to the global dimension.

This seems to be not only a major challenge in bridging the gap between the constitutional theory of federations with economic (policy) theory but also the crucial topic to test the capability of economics to escape a trap of radical and increasing incoherence between its positive dimension and *the world as it really is*. This gap risks condemning economics to irrelevance and ineffectiveness.

^I A very interesting writing is an Appendix on *Institutions, Economics and Politics* in Montani (2008: 227-234) but it is unfortunately in Italian.

^{II} Imagine everyday decisions in our lives were taken according to a veto rule!

^{III} I here recall that both share the multi-layer nature but a “structure” is characterized by a lack of any bi-univocal relation between the different layers whereas a “system” is a complex set of relationships of interdependence among such layers with one or more common functions.



^{IV} I thank the two anonymous referees of this journal for suggesting such questions.

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