

Competitive Federalism in Institutional Perspective

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The two terms in my title, “competitive federalism” and “institutional perspective”, call for some prefatory comment. Competitive federalism is an intellectual construction that locates governance within an openly competitive approach to processes of social organization. This construction stands in contrast to that of dual federalism, which envisions different levels of government as possessing sole, monopolistic authority in their assigned areas. A theory of competitive federalism has both positive and normative elements. Both elements assert that the relative sizes and spheres of activity of governments as well as of private organizations are all emergent properties of a competitive process. The normative element goes further and asserts that it is desirable that this competitive process be open, in opposition to a competitive process that is restricted and rigged.

Any competitive process is framed by a set of rules and principles that govern the interactions among the participants in that process. An openly competitive process is a game in which anyone can participate. The classic vision of a market economy is one of open competition. Any person can enter any business, provided only that he play by the general rules of property and contract. If someone wants to start a new airline, there is no person or office whose permission he must secure before he can do so. There will, of course, be many people he will have to convince to join in, if his enterprise is to be successful. These include investors, creditors, employees, and customers, all of

whom also operate within the bounds of the rules of property and contract. But there is no particular person or office whose permission is essential, without which the enterprise could not go forward. Enterprises grow or shrink, depending on the amount of support they can secure throughout the society, in a context where everyone is equally free to act similarly.

This paper is concerned primarily with the institutional characteristics of a competitive federalism.¹ This construction treats governments as operating according to the same general institutional framework as other units in society. The sizes of different units of government and their spheres of activity, both relative to each other and relative to privately organized enterprises, are determined through a process of open competition. My focus is thus on the institutional framework that would accommodate such a process of open competition. This stands in contrast to much of the economic literature on federalism, which concentrates instead on resource allocations. Resource allocations, however, are not objects of direct choice, but rather are emergent properties of an institutional framework. For this reason I give primacy of attention to the governing institutional framework.²

I start by characterizing the predominant approach to federalism as one that is concerned with the geographical organization of government and the assignment of activities to those governments. I then describe some of the problematical features of the analytical agenda that emerges from this approach to federalism. Subsequently, I bring an institutional orientation to bear on those problematical features, reviewing in the process the Wicksellian approach to

fiscal organization. I follow this with an exploration of some institutional requirements for a competitive federalism. I close with a brief review of some major constitutional developments in the history of American federalism, primarily as a means of giving further elaboration to the institutional order of a competitive federalism.

Assignment, Mapping, and the Geographical Organization of Federalism

In a federal form of government, people simultaneously are taxed and regulated by at least two independent governments. In the United States, for instance, people are taxed and regulated by both federal and state governments, each of which possesses independent constitutional authority to do so. To be sure, Americans typically pay taxes to and receive services from more than two governments, as county and city governments also impose taxes and provide services. So do a wide variety of special districts whose boundaries typically cut across those of other units of government.

The legally and politically oriented literature distinguishes between federal and unitary governments on the basis of the locus of constitutional authority. The relationship between federal and state governments in the United States would be considered federal because each possesses independent constitutional authority. In contrast, the relationship between a state and the counties and cities located within its boundaries would be considered unitary and not federal. Counties and cities do not possess independent constitutional standing, but rather owe their existence and derive their powers from acts of state legislation.

While the independent constitutional standing that states possess surely provides them with some options that the cities and counties located within their boundaries do not have, the distinction between federal and unitary relationships should be neither exaggerated nor ignored. On paper, state legislation may be capable of abolishing, combining, or dividing and recombining cities and counties at will. In practice, however, this is not so simple or easy. Cities and counties surely have significant influence within state legislatures to render this generally a difficult thing for a state to accomplish.

The economics literature has largely used federalism simply as a synonym for any decentralized form of government. So long as people pay taxes to and receive services from two or more units of government, each of which has some sphere of independent action even if that sphere is granted through legislation from a higher level government, federalism is said to be present. While this procedure captures much of importance about decentralization, it does shield from view some important institutional means by which decentralization is accomplished. Whether governments are constitutionally independent of one another, or whether one government derives its position and power from acts of another government, is an important institutional consideration, as I shall explain below.

Any federalist system of government can be described by placing a multi-layered map over its territory. Besides possessing multiple layers, that map could be thicker in some places than in others. The first layer of the map would cover the entire national area, and would delimit the boundaries of the national or

federal government. The map's second layer would partition that national territory into a set of exhaustive and mutually exclusive units typically called states or provinces. At a minimum, a federal government would have these two layers. It is common, though, to have even more layers. In the United States, for instance, all citizens would face a third level of government, as each state territory is divided into exhaustive and mutually exclusive counties. For some Americans this ends the number of governments they face, but many face even more governments. Many people reside in cities that also impose taxes and provide services, though there are also cases where city and county are identical. Beyond this, there are a large number of special districts that provide such services as education, fire protection, soil conservation, drainage, sewerage, water supply, and cemeteries, to mention just a few examples.

When federalism is approached from the perspective of assignment and mapping, attention is drawn to such things as the number of layers of government and the boundaries that pertain to any one layer. Indeed, the bulk of the economic literature on federalism has approached federalism as a task of mapping territory and assigning functions.³ The animating vision of this geographical approach is to divide a national territory into jurisdictions whose boundaries coincide with the territory being served by a particular governmental function. Publicly provided services are thought, in this vision, to have different areas of coverage. Armed forces, for instance, cover the entire national territory, and would be suitable for provision by the national government. By contrast, the location and timing of traffic signals affect traffic flows in only a confined area,

and would be suitable for provision by local governments. Alternatively, the size and location of major highways affects people over a wider area, and would be suitable for supply by a larger government, say a state.

It would be possible in this vein to imagine someone running through the entire array of governmental activities and assigning their provision to different levels of government. To be sure, any effort actually to do this would quickly become mired in the complexity of the task. There would be a continuum of services and geographical ranges, and this exercise in mapping would call for a huge number of overlapping jurisdictions. The map of governments and their activities would be vastly more complex than it actually is. The number of governments that people face, however, is much smaller than the number of services they receive from government.

It is quite clear that actual maps have not been drawn to resolve any type of assignment problem. Nonetheless, it might seem as though the formulation in terms of assignment provides a useful orientation, one, moreover, that finds at least some correspondence in reality. The federal government and not states or localities provide military forces. State and local governments, on the other hand, provide protection against such forms of civil disorder as rioting and looting.

The three main geographically oriented questions that arise in the political economy of federalism concern the number of layers of governments, the sizes or boundaries of governments at any particular layer, and the methods and processes by which controversies and disputes among governments are

resolved. One approach to exploring these questions is to start with a wholly centralized government, and then to examine the benefits and costs of increasing degrees of decentralization or fragmentation. What would it matter, for instance, if elementary education were nationalized or if it were supplied locally?⁴ In the wholly centralized state, uniformity would prevail in all relevant dimensions. The curriculum would be the same everywhere, as would the hours of operation, the methods of instruction, and everything else of relevance.

The introduction of decentralization allows for variability in the provision of education, or of any other service, within the national territory. Just how much variability depends upon how much decentralization there is and the forms it takes. A national area may be divided into ten, a hundred, or a thousand units. Moreover, those units may be creatures of a higher-level of government or they may have independent constitutional existence. How much decentralization is actually represented by this increasing number of units depends on the autonomy that the individual units possess, which in turn is governed by the institutional framework within which all participants within the society interact, whether governmentally or privately organized.

One significant strand of the literature on federalism has stressed the gain that local autonomy can provide by making possible a fuller accommodation of variation in peoples' preferences. Those preferences can refer to an almost limitless variety of specific details. Some of these preference details might be relatively minor, as in the selection of colors with which to paint schools. Others might be regarded as generally of more significance, as in the hours of operation

or the rules and procedures regarding discipline. Yet other dimensions of preference might be regarded as of still greater significance. These might include components of the curriculum.

For instance, one jurisdiction might have extensive coastal property and no mountains, while another might be landlocked and highly mountainous. In teaching health and safety, schools in the coastal jurisdiction might want the curriculum to stress water safety. In similar fashion, schools in the mountainous jurisdiction might want a curriculum that stresses the opportunities and dangers that are particular to mountains. Decentralization makes it easier to accommodate such differences in preference.

Alternatively, some people might prefer what might be called a relatively progressive curriculum that is characterized by such things as a look-and-say approach to reading, and with the reading materials chosen from contemporary authors who write in a vernacular style. Other people might prefer what might be called a saber-toothed or Neanderthal approach, where reading is taught through phonics, and with the materials coming largely from classical sources, including the Bible.

To the extent people differ in their preferred approaches to education, decentralization makes it possible to accommodate those differences more fully than would be possible under centralization.⁵ Table 1 illustrates this ability of decentralization. That table shows a national area where there are 150,000 people, 80,000 of whom prefer a progressive curriculum and 70,000 of whom prefer a saber-toothed curriculum. If education is provided nationally, 80,000

people will get the curriculum they prefer and 70,000 will have to tolerate what to them is an inferior curriculum.⁶ Suppose, instead, that education is provided locally under majority rule, with there being three jurisdictions. Alpha will provide a saber-toothed curriculum while Beta and Gamma provide progressive curricula. With decentralized, federal provision, 110,000 people have their preferences satisfied. Federalist organization reduces from 70,000 to 40,000 the number of people who will have to suffer what they regard as an inferior curriculum.

To be sure, the numbers presented in Table 1 were selected arbitrarily to make the point. Yet there is sound reasoning and good evidence behind this point, which was initially articulated by Charles Tiebout (1956) and which has received considerable subsequent examination. A federal form of government makes it possible for people to sort themselves among jurisdictions according to their preferences. If people differ in their preferences for educational curricula and if education is supplied locally and not nationally, variations in curricula will tend to emerge. This will happen for both supply-related and demand-related reasons. On the supply side, political processes and entrepreneurs will generate differences across jurisdictions in curricula offerings, in an effort to make their locales attractive to people. On the demand side, mobile residents will respond to those differences by moving toward those jurisdictions whose combination of taxes and services they find relatively attractive.

If the ability of federalism to accommodate variations in preferences represents the benefit side of federalism, the possible externalities that might be associated with decentralization represent the cost side in the standard

formulations. Burton Weisbrod (1964) articulates this possibility nicely for education. To the extent children who are educated in one jurisdiction subsequently move and become residents of other jurisdictions, external effects may be transmitted among jurisdictions. This possibility leads directly to assertions that lower-level choices will be inefficient, unless there are higher-level programs to internalize those externalities. Much of this literature supports grants or regulation as a means of internalizing those alleged externalities. One possible line of argument in this instance would be to claim that local schooling would be under-supported in the presence of resident mobility. The claim in this case would be that local residents bear the full costs of operating local schools, but many of the benefits flow elsewhere through mobility. To advance some such claim of externality does not, by itself, demonstrate the accuracy of that claim, as I shall explain below.

Another feature of decentralization is the scope for experimentation and innovation that it allows.⁷ Where a unitary system would make a choice between the progressive and the saber-toothed curricula, a decentralized system would allow both to be tried. The choice between curricula may be simply a matter of accommodating differences in preferences without any other consequences. But more than this might be at stake. One approach may have consequences that people value generally more highly than would emerge under the other approach. This connection between consequence and approach, however, can be established only through observing the results of experimentation where different units take different approaches. For instance, children who are

schooled under the saber-toothed curriculum may develop relatively civil, energetic, and provident characters while children who are schooled under the progressive curriculum may develop relatively rude, lazy, and short-sighted characters. A federal system of decentralized government allows for a greater range of experimentation, in addition to providing for a greater accommodation of personal preferences. It also generates possible clashes among people that arise out of externalities and other forms of miscoordination that might be mitigated through centralization.

In principle, the compound republic that a federal form of government represents creates a potential for a mutual monitoring among governments which is absent in a unitary system.⁸ Consider a constitutional provision that governments cannot take private property unless that taking serves a valid public purpose and unless the owner has been justly compensated. In a simple republic, a citizen who thinks his government has violated this constitutional principle has no alternative but to lodge his complaint with an office of the same government that is the object of the complaint. The simple republic must be asked to stand in judgment of itself. It can be different in a compound republic. There, it is possible that complaints against one level of government can be taken to an office of another level of government.

Some Institutional Problematics of Geographical Assignment

For purposes of advancing a line of argument, it is typical for an analyst to presume to possess the knowledge that would be necessary to “solve” the

problem under examination. Thus armed with knowledge about demand and supply conditions in a market, the analyst can “solve” for the price and quantity that clear the market. There is nothing particularly wrong with this procedure, though it is incomplete. Much of this incompleteness resides in the neglect of the institutional framework that allows the so-called solution to occur in practice. Conditions of demand and supply, or even the actual extent of a particular market, are not data that are known in advance to anyone. Rather they emerge out of interaction among people when those interactions are governed by the legal framework characterized by the principles of property and contract, along with the associated institutions, organizations, and conventions that have emerged out of past interactions.

It is a well-known proposition that a centrally planned economy, where all markets, exchanges, and prices are abolished, is impossible. This is not to deny that various forms of socialism were prevalent in the world for much of the 20th century, but is only to assert that those regimes never truly abolished property and contract, but rather created forms of those institutions that promoted poor levels of economic performance.⁹ Markets, exchanges, and prices exist in all economies, only in some the institutional framework is more effective in organizing those social interactions in fruitful, wealth-generating ways. Some institutional orders are more effective than others in promoting the creation and use of knowledge and in generating incentives that support such promotion. This proposition about economies in general holds for the institutions of federalism as well.

It is easy enough to state that as a matter of principle, decentralization should be pursued to the point where the marginal gain equals the marginal cost. The marginal gain might be appraised as the increase in consumer surplus that results from a finer accommodation of differences in individual preferences. The marginal cost might be appraised as the loss of consumer surplus that results from the spillover effects attributed to decentralization. There is nothing wrong with this as a statement of principle, though there are other possible statements of principle that could be advanced as well. This statement of principle, however, does not address the framework of institutions within which a particular pattern of federalist organization is established, maintained, or revised. Such phenomena as changes in consumer surplus attributable to preference accommodation and spillovers are not things that are known to anyone in some central location, any more than market conditions of demand and supply are centrally known. For both settings, that knowledge is distributed among individual participants, and what happens from that point of departure depends on the institutional framework that governs interactions among those participants.

It is the same with claims about externality. It is easy to construct a model where externality and inefficiency is present. It is difficult, though, to explain why such models are cogent, because they all entail the existence of unexploited gains from trade among the participants. It is impossible to point to the presence of some such program as a grant or regulation as evidence in support of the claim that it is offsetting some externality. Possibly it might be doing so, but

grants and regulations may also be created to restrict competition and secure subsidies for politically favored clienteles.

For instance, the same claim about externalities in education could be advanced about externalities in governmental choices regarding the construction, maintenance, and use of highways. This might seem to justify federal grants to states for highway construction, something that in turn led to federal control over drinking ages and speed limits. Rather than internalizing external effects across states, those programs may be means of shifting prices and incomes in favor of particular clienteles. Federal authority in this instance would be the instrument by which open competition among states and localities is blocked from undermining those subsidies.

Consider, for example, the federal imposition through most of the last quarter of the 20th century of a 55 MPH speed limit. State compliance with this program was secured by making the receipt of federal grants conditional upon state compliance with the federal regulation. State residents pay the same federal taxes regardless of whether they receive some of their taxes back in highway grants. In this setting of duress, it is quite reasonable to expect states to comply with the federal regulation. It is quite unlikely that this regulation had anything to do with internalizing externalities. One of the things it did accomplish, however, was a pattern of price shifts and wealth transfers that would not have taken place under open competition.

There are places in the nation where people would typically drive much faster than 55 MPH, all relatively open and uncongested areas being examples.

There other places where it is difficult even to reach 55 MPH, much of the heavily urbanized, northeastern corridor being an example. The imposition of 55 MPH has no effect on the time spent traveling by people who could never or would rarely drive 55 MPH anyway. The full burden of the additional loss of time spent traveling is placed on those who live in places where they would find themselves often driving faster than 55 MPH. The reduction in the speed of travel also reduces gasoline consumption. This in turn would lower the price of gasoline from what it would have been without 55 MPH. Hence, people who live in areas where speeds rarely exceed 55 MPH would spend no additional time in traveling, and would secure price reductions for their gasoline. People who lived elsewhere would also face the lower price for gasoline, but would also spend a greater share of their lives in their cars. Their own previous conduct, moreover, showed that they would have paid a higher price and spent less time traveling, for they always had the option of driving more slowly and saving gasoline.¹⁰

Allocative outcomes are simply emergent outcomes of some constitutive institutional framework. Recognition of this suggests that analytical primacy should be given to institutional regimes and not to allocative outcomes. Rather than concentrating on a statement of nonverifiable analytical conditions, the focus would be on the properties of institutional regimes. In contrast to the illustrations of nonverifiable analytical conditions given above, a requirement that senators shall be chosen by state legislatures illustrates an achievable institutional arrangement. So, for that matter, is a requirement that senators shall be elected directly. How these institutional arrangements relate to various

statements of analytical conditions is a task for the analytical enterprise to uncover. Under the right kinds of institutional arrangements, perhaps the desired analytical conditions will occur. It is the institutional arrangements, however, and not the analytical conditions that are open to choice.

This distinction between a theory addressed to achievable institutional arrangements and one addressed to unverifiable analytical conditions is illustrated nicely by a comparison of the central contributions to public finance associated with Knut Wicksell and Erik Lindahl (as noted in Wagner 1988). The bulk of the attention in the literature on public finance has been paid to the model of Lindahl pricing as a characterization of efficiency in the supply of public services. By this construction, efficiency in a particular public output results when the summation of the individual evaluations of the marginal unit of output equals marginal cost. This construction proceeds in terms of nonverifiable analytical conditions. There is no way that a claim of efficiency or inefficiency can be verified or refuted directly by observation. Individual evaluations of public services are not directly observable, and so could not be used by some central authority to impose an efficient outcome.

Neither is marginal cost directly observable. It is true that economists have estimated numerous cost-output relationships econometrically. Those observations, however, are generated within a particular institutional framework, and they pertain to some past historical period. Cost in economics is defined as a boundary condition, where any particular output is produced in the least-cost manner. While it is possible to produce that output in a more costly manner, it is

impossible to produce it at a lower cost. What makes it seem plausible to claim that observed cost correspond to the least-cost boundary is a belief about the properties of the institutional framework of a market order. There is no external authority that someone can consult to determine whether production actually takes place in least-cost fashion. But in a framework of private property where the owners of enterprises own the difference between the receipts their enterprises generate and the associated expenses of production, it seems reasonable to claim that people generally are particularly diligent and energetic in operating their enterprises. If such residual claimacy were absent, however, the basis for believing that actual costs of production correspond to the theoretical notion of least-cost production is weakened.

The Wicksellian contribution to public finance was to set forth institutional arrangements under which the actual tax shares that people pay can be characterized as Lindahl prices, even though there is no way that this could be verified directly through observation. Rather, Lindahl prices are a reasonable inference about the logic of the set of institutional arrangements articulated by Wicksell. Lindahl prices are embedded in the Wicksellian institutional framework.¹¹ Within that institutional framework, a parliament would be selected on the basis of proportional representation, and in such a way that the parliament could be a reasonable miniaturization of the overall population. Proposals for appropriation would be joined with proposals to pay for the appropriation, and with the joint proposal requiring a relatively high degree of support within the parliament to be enacted. Ideally for Wicksell, that high degree of support was

unanimity, but as a practical matter he allowed that something on the order of three-quarters or four-fifths might be a reasonable compromise in the interest of expediency. Since people would not support budget proposals if their marginal costs exceeded their marginal evaluations, it is reasonable to conclude, as a first approximation, that the Wicksellian institutional framework would generate something that could be described in terms of the model of Lindahl pricing. At the same time, however, it would be no more possible to use that model independently to compute a set of Lindahl prices than it would be to use a model of a market economy independently to compute market prices.

Wicksellian Principles and the Competitive Federal Republic

The approach to federalism taken here is one that can be characterized as competitive federalism. The literature on federalism contains a number of different conceptualizations, among them being cooperative federalism, dual federalism, and coercive federalism.¹² The vision of a competitive federalism would seek to assimilate the Wicksellian framework, which was articulated for a unitary state, to a federal state.

One of the most notable things about the Wicksellian approach to government is that there is no limit on the size or scope of government authority. The size of government in Wicksell, and the kinds of things that government does, is not subject to constitutional specification, but rather is determined residually as a by-product of open competition within the institutional framework he set forth. Whether a service is provided by a government or by some private

firm depends on the relative competitive abilities of different enterprises. The size of government will expand relative to private entities, so long as political entrepreneurs are relatively more successful than private entrepreneurs in gaining support for their projects, with the conditions for gaining support being described by the institutional framework Wicksell described. In similar fashion, the relative sizes of different levels of government will also depend on the relative success of different political entrepreneurs in gaining support for their projects.

The Wicksellian approach would not look to any assignment of functions across jurisdictions. Which jurisdictions do what, and to what extent, would be an emergent property of the competitive process itself. A competitive federalism would make no effort to specify the kinds of activities that different levels of government could or could not undertake. Governments at all levels would be free to pursue political profits wherever those profits were to be found. Hence, the result of a system of competitive federalism would be one where the aggregate size of all governments, as well as the relative size of federal and state governments would be determined residually as a by-product of a competitive process, whose institutional features remain to be defined. For instance, the extent to which education is organized privately through market arrangements, or collectively, and if collectively, whether through states or the federal government, would be determined through an open competitive process among politicians, interest groups, and citizens generally. In this way the industrial organization of a system of governance would be governed by the same principles as govern industrial organization elsewhere in the economy.

The Wicksellian institutional framework is one that envisions government as operating within the economy, as against directing or overseeing the economy. Government is to operate in congruity with the same institutional principles of property and contract as other people and organizations within society. This is represented by Wicksell's selection of a principle of near unanimity. It is also represented by his advocacy of some system of proportional representation, which can lead to everyone being represented by someone for whom they voted. This is a situation that is impossible to achieve with single-member constituencies.

While there are many ways a vision of competitive federalism might be put into practice, the institutional requirements for instantiating such a vision of competitive federalism differ in important respects from current practice. James Madison articulated some useful principles for a competitive federalism in *Federalist* No. 51. There, he argued that a compound republic would enable governments both to control themselves and to control each other. As he explained: "In the compound republic of America, the power surrendered by the people is first divided between distinct governments, and then the portion allotted to each subdivided among distinct and separate departments. Hence a double security arises to the rights of the people. The different governments will control each other, at the same time that each will be controlled by itself."

Consider again the preceding illustration of the federal imposition of 55 MPH. Two hypotheses can be examined as possible explanations for this imposition. One would be grounded in some claim of externality and its control.

Another would be grounded in some claim of dominant groups of politically expressed interest to gain advantage at the expense of others. If externality and its control is the accurate explanation, 55 MPH is universally beneficial, or can be made to be so by virtue of the Coase Theorem (Coase 1960). This is a simple arithmetical consequence of the presumption of externality, for this presumption implies that a program that internalizes the externality will generate a social surplus. While there are many ways such a surplus might be distributed, it can always be done in such a way as to command universal assent.

In this setting, a provision that allowed states to withdraw from the grant program, and simultaneously reduce federal tax contributions by state residents, would find no takers. Should states choose to opt out of such a program, it would be evidence against the claim that this particular federal program was a means of internalizing externalities that arose out of the interaction among state choices. It would rather constitute evidence for the proposition that this program was operating to restrict competition, by establishing positions that would be sheltered against competitive forces. Residents in the northeast and in other congested areas, for instance, would be sheltered from competition for gasoline by residents of less congested areas.

Some Institutional Requirements for a Competitive Federalism

In the remainder of this paper, I shall examine just three of the many possible institutional elements that could comprise the institutional framework of a competitive federation. These are the possession of independent taxing

authority by the federal government, the ability of the federal legislature to appeal directly to the citizenry for its selection, and the ability of the federal judiciary to rule on challenges to the constitutionality of federal actions. The first two of these elements were the subject of the 16th and 17th Amendments, both of which were ratified in 1913. The 16th Amendment gave the federal government the power to impose an income tax, where before it had pretty much been limited to tariffs. The 17th Amendment initiated the direct election of Senators, where before Senators had been appointed by their states. The third element was perhaps most fully resolved by the Civil War, and in any case provides a good vehicle for examining some of the properties of the dual security articulated by Madison in *Federalist* No. 51.

I shall start with a simple model, one that perhaps corresponds reasonably well to the Articles of Confederation. To keep matters small and simple, suppose there are five states (and not 13), each of which contains five people (as against an average population of around 300,000 per state). Further suppose each state has a single vote in a federal assembly. I further assume that the states are small in size, as is the cost of moving from one jurisdiction to another. The members to the federal assembly are appointed by the states, and federal revenues are paid by the states.

This model would seem to possess the central features of a competitive federalism. The federal government can expand only by convincing residents in all states that particular federal programs are better than alternative state or private programs and activities. The federal government is pretty much in the

position of a market-based enterprise, in that it secures support to the extent that it is able to convince its state clients to provide that support.

The individual states are in a similar position. So long as states are small and the cost of mobility low, it matters very little whether states operate according to majority rule or some form of qualified majority. There are several circumstances under which majority voting and unanimity can give the same outcomes. One resides in uniform preferences within a jurisdiction, in conjunction with provisions for nondiscrimination in taxation; if people have the same preferences for public services and if it is impossible for governments to practice tax discrimination, unanimity and majority rule give identical results. Another resides in incentives in the face of easy mobility; if residents can change jurisdictions cheaply and easily, governments will have little ability to practice tax discrimination. In either case, it is possible to imagine institutional circumstances under which the differences between unanimity and majority rule are small, and may vanish as a limiting condition. It is for this reason that I treat states initially as if their choices are made under unanimity, even if their actual procedures called for majority rule. Whether this is brought about mostly by homogeneity or by competitive pressures is irrelevant at this point.

To be sure, it might be objected that states are too large to be considered in this manner, even if localities might be so considered. There is certainly merit in this objection. After all, the Tiebout literature has focussed on local and not state governments. While mobility among states is surely more costly than mobility among localities, it is also surely the case that the most significant

divergence in mobility costs lies in that between states and the federal government. Furthermore, and historically speaking, it should be kept in mind that the United States contained 13 states and four million people at its founding. Contemporary Switzerland contains 26 cantons and seven million people. For the United States to have government on the Swiss scale, the United States would now require close to 1,000 states.¹³

In the model at hand, however, federal revenues will require the approval of the states. There is not even any room for geographical coalitions at the federal level, as would be illustrated by three states approving projects of benefits to them, the dominant share of the cost being placed on the other two states. For those two states could simply withhold their payments. This simple model of a federal system not unlike that which exist early in the American constitutional founding seems to have Wicksellian-like characteristics, in that taxation reflects a rough consensus among taxpayers. What drives that consensus is competition and homogeneity at the state level, and the absence of an independent taxing authority at the federal level. The use of majority voting is irrelevant in this setting. This changes when the federal government attains independent taxing authority, even if states continue to select federal legislators. It changes even more if federal legislators are selected by direct vote. In both cases, the direction of change is an expansion of government, particularly at the federal level.

The ability of the federal government directly to tax individuals, which was made possible by the 16th Amendment, makes regional coalitions possible. This

Amendment broadens the scope for the federal government to practice fiscal discrimination among regions. It becomes possible for the federal government to enact programs that receive the approval of three states, even though the other two states oppose the program. In the five-state model, this would characterize a setting where citizens in three of the states are able to get their preferences satisfied more fully through federal provision than through state provision. This fuller satisfaction would arise, however, not because the federal government was more efficient in providing those services, but because it was able to impose costs on residents of the other two states via its the independent taxing authority. The creation of an independent taxing authority for the federal government allows it to serve as an arena for the organization of geographical coalitions that can approve measures that impose costs on those who don't belong to the coalition, but who must pay federal taxes anyway. The protection against this prospect that was afforded by practical unanimity within small states is undercut by independent federal taxation.

In this model of a 16th Amendment without a 17th, redistributive coalitions are limited to states, due to the institutionally grounded homogeneity within states. There is comparatively little scope for the formation of coalitions whereby subsets of people within particular states are arrayed against other subsets. It is the selection of federal legislatures by states that prevents, or at least mitigates against this form of coalition formation. Faction is pretty much limited to those based on geography, because the federal tax base must receive approval from state legislatures via the state selection of federal legislators.

Should the federal legislature be elected directly, as provided by the 17th Amendment, an additional movement away from consensual governance is created. With federal legislatures selected directly, opportunities for coalition within states are expanded. One reason for this is that the base of taxation is no longer determined by states but is determined by the federal government. This expands the scope for rent-seeking by creating federal definitions of tax base that cut across state lines. Coalitions no longer need to be regional, as illustrated by coalitions of some states against other states. Coalitions can now be industrial, and these can involve a coalition of people within several states against the remainder of the citizenry. There is no longer any presumption of uniform treatment across people within any particular state.

The competitive bias in the use of taxing authority brought about by direct election as well as direct taxation are reinforced by a judicial bias. Recall the dual security claim of Madison in *Federalist* No. 51, where each level of government polices the other. In fiscal matters, this dual security is a feature of the Wicksellian framework. But what about the exercise of police powers? There is a significant judicial asymmetry here, as noted in Niskanen (1978). Claims that a state legislature oversteps its bounds can be heard before federal forums. This is consistent with the proposition that no man should be a judge in his own cause. However, similar claims about the federal legislature can be heard only within federal offices. The federal government is a judge in its own cause. It is surely notable in this respect that relatively few acts of federal

legislation have been called unconstitutional by the federal Supreme Court. The vast preponderance of cases has been against state legislation.

There is now a large literature that treats such independent agencies as the Federal Reserve and the Federal Trade Commission as agents of some political sponsor. There is considerable controversy in the literature over such matters as the relative importance of executive and congressional positions in this process. Where some argue the Fed acts as an agent of the President, others argue that it acts as an agent of the banking committees of Congress. These points of controversy aside, what is particularly noteworthy is that this literature uniformly treats independent agencies as agents in the service of dominant political interests. Why should it be any different for the Supreme Court, or for inferior courts? True, justices have lifetime tenure, where members of the Fed are appointed for 14 years. Suppose lifetime tenure is equivalent in expectational terms to an appointment for 20 years. How does an appointment for 20 years compare with an appointment for 14 years? If a 10 percent rate of discount is applied to future events and circumstances, an appointment for 14 years is worth 74 percent of eternity, while appointment for 20 years is worth 85 percent. The difference between the two appointments would seem to be relatively minor, which would seem to indicate that those same agent-principal principles that have been brought to bear on the Federal Reserve can be brought to bear on the judiciary as well, as Toma (1991) points out. Madison's principle of dual security would seem to require that claims about federal constitutionality

should be heard in state-convened forums, in one fashion or another, for otherwise the federal government is standing as a judge in its own cause.

Such things as direct taxation and direct elections, along with the inability of state bodies to rule on the constitutionality of federal action, biases the processes of federalist competition in a direction that favors federal action over other forms of action. Such biases will have to be addressed in any effort to move our federalist system in a competitive direction. Such greater competitiveness could be accomplished in good measure on the fiscal side somewhat along the lines advanced in Dwight Lee's (1996) proposal for reverse revenue sharing, and in a way broadly consistent with the principle that no man should be a judge in his own cause. There are many ways that a greater measure of genuine competition could be injected into our federalist system of government, and I have covered only a few possible options in this respect. In any case, and in one fashion or another, Madison's principle of dual security will be treated substantively and seriously, and incorporated institutionally into the organization of our governance, perhaps thereby achieving some blending of the federalists and antifederalists, though in a way suitable for our time.

Table 1

Centralization, Decentralization, and Preference Satisfaction

Government	Progressive	Saber-toothed
Alpha	10,000	40,000
Beta	40,000	10,000
Gamma	30,000	20,000
Total/National	80,000	70,000

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Endnotes

¹ For an extensive treatment of federalism as a competitive process, see Thomas Dye (1990).

² For a fascinating treatment of Adam Smith's *Wealth of Nations* in terms of a contrast between the traditional economist's focus on resource allocations and an alternative focus on institutional arrangements, see Nathan Rosenberg (1960). The primacy of institutional framework over particular resource allocations is the central tenet of ordnungstheorie, the classic statement of which is Walter Eucken (1952).

³ The modern classic statement of this perspective is Wallace Oates (1972). This perspective is revisited and generally reaffirmed in Oates (1999).

⁴ I recognize that there are good arguments for private, market-based supply, but to consider that option here would distract attention from my focus on federalism. To be sure, in the end the vision of competitive federalism covers not just competition among governments but extends as well to competition between private and public forms of organization.

⁵ For an influential empirical examination of this proposition, see David Bradford and Wallace Oates (1974).

⁶ Or else turn to some private alternative, if this is allowed, though in this instance they would still have to pay taxes to support the public schools.

⁷ This point is explored in Vihanto (1992).

⁸ The principles of a compound republic are described carefully and thoroughly in Vincent Ostrom (1987). For further elaboration and amplification, see Robert Bish (1999).

⁹ This is explained with particular clarity in Paul Craig Roberts (1971).

¹⁰ To be sure, some might argue that the justification for 55 MPH was rooted not in the control of externality but in the imposition of safety. The bulk of the evidence, however, finds that it is not increased speed so much as increased variability among the different speeds of drivers that leads to increased accidents (Lave 1985). This would suggest that a jurisdiction that boosted its speed limit to 80 MPH, while at the same time imposing a minimum speed limit of 70 MPH, could achieve a lower accident rate than one that imposed 55 MPH.

¹¹ In the same fashion, production and cost functions are inferences about the properties of the logic of capitalist institutions grounded in residual claimacy. They are not subject to direct calculation and they are not subject to verification, for there is no way ever to determine what is truly the least cost way of producing anything. Rather what we say is that the logic of residual claimacy gives strong incentive for people to discover least-cost forms of production.

¹² See, for instance, the presentation in Kenyon and Kincaid (1991).

¹³ In this respect, a number of antifederalists thought that some states were already on the verge of becoming too large, and they supported means for accommodating a subdivision of the existing states. See the presentation of antifederalist thought in Herbert Storing (1981)(1985).