American Federalism

Competition Among Governments

Thomas R. Dye
Florida State University

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Preface

> In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself."
>
> ——James Madison, *Federalist*, Number 51

The founders of the American nation understood that democratic political processes alone could not be depended upon to restrain governmental power and protect the liberties of individuals. They believed that "auxiliary precautions" were essential in controlling government and restraining "unjust and interested" majorities. The founders also understood that written constitutional limits on government, "parchment barriers," would not enforce themselves and that the solution to controlling government power lay in creating "opposite and rival interests" within government itself. Federalism is not only competition between the national government and the states, the topic of most modern scholarship; it is also competition among state and local governments.

American Federalism: Competition Among Governments sets forth a theory of competitive federalism: the encouragement of rivalry among state and local governments to offer citizen-taxpayers the best array of public services at the lowest costs. It argues that eighty thousand governments are better than one—that intergovernmental competition was recognized by the founders as an auxiliary precaution against the monopoly abuse of power by a single centralized government. It develops arguments for truly federal, competitive, and decentralized government: greater overall satisfaction of citizen preferences, incentives for government to become efficient and provide good-quality services at their lowest costs, restraints on the size of the public sector and the tendencies of governments to oversupply goods and services, greater responsiveness to the policy preferences of consumer-taxpayers, restraints on the overall burdens of taxation and the imposition of nonproportional taxes, encouragement of economic growth, and experimentation in policies designed to improve the well-being of citizens.

Competitive federalism is different from past popular conceptualizations of federalism, most of which focused on nation-state relationships rather than competition among state and local governments. Federalism is not merely

decentralized national government, and it is certainly not an effort to achieve cooperation among national, state, and local governments in carrying out national policy.

Competitive federalism requires that state and local governments have significant and independent responsibilities for the welfare of people living in their jurisdictions. These governments cannot be truly competitive if the federal government determines national priorities and assigns responsibility to state and local governments for policy implementation. Nor can state and local governments be truly competitive if the costs of their decisions can be externalized—shifted through federal grants-in-aid to the national government and to taxpayers throughout the nation. Competitive federalism requires that voter-taxpayers within the states bear the burdens, as well as the benefits, of their own choices.

This book shows that state and local government is still a significant sector of the economy and responsive to the demands of citizen-taxpayers. It argues that in the performance of their major functions, especially education, state and local governments are generally responsive to demands of consumer-taxpayers. Despite a nationalization of the economy, policy differences among the states are not diminishing; both the benefits and burdens of government vary considerably from state to state. Political competition within the states is shown to have little policy relevance. Even in competitive states, a change in party control of state government seldom results in significant policy alterations. Competitive federalism operates independently of the types of political systems within the states to insure responsiveness.

The book also shows that public policy in the states makes a difference in the economic well-being of their citizens. Both the taxing and spending decisions of these governments have economic consequences—identifiable effects on the personal income of individuals. The wealth of states, like the wealth of nations, is affected by government policies.

The book concludes with a discussion of the values of federalism and intergovernmental competition, the implication of competitive federalism for public policy, and specific constitutional and legislative prescriptions designed to strengthen competitive federalism in the U.S. system of government.

The ideas set forth in this book challenge fifty years of scholarship on American federalism. The academic euphemisms used to legitimize centralized government—"partnership," "cooperation," "sharing"—are explicitly rejected in favor of the founders' original notion of encouraging "opposite and rival interests" within the structure of government. Many in the academic establishment will feel threatened by ideas that challenge centralized monopoly government, and many political scientists will feel uncomfortable with ideas derived from market analogies. Indeed, the "public choice" model, which inspires much of the analysis in this book, will confound those who

confuse rational choice with conservatism. But we hope that even the most devoted centralists will at least consider the arguments set forth here and allow their students to confront them. We hope to convince readers that our notion of competitive federalism better reflects the founders' original concept of American federalism than most current scholarship on the topic.

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1
Federalism as Competition

> I put for a general inclination of all mankind, a perpetual and restless desire for power after power, that ceaseth only in death.
> —Thomas Hobbes, *Leviathan*, 1651

> The very principle of constitutional government requires it to be assumed that political power will be abused to promote the particular purposes of the holder; not because this has always been so, but because it is the natural tendency of things, to guard against which is the especial use of free institutions.
> —J.S. Mill, *Considerations on Representative Government*, 1861

Chaining Leviathan

All governments, even democratic governments, are dangerous. They wield coercive power over the whole of society. They tax, penalize, punish, limit, confine, order, direct, and regulate. They seize property, restrict freedom, and even take lives, all under the claim of legitimacy. Governments expect people to accept these vexations as rightful. Thomas Hobbes justified the creation of such a dangerous institution by arguing that it was the only alternative to anarchy—a war of all against all, "where every man is enemy to every man" and life is "solitary, poor, nasty, brutish and short." Only the "continual fear and danger of violent death" justified the establishment of a Leviathan.

Democracy offers little protection to individuals. The founders of the American nation were acutely aware of the vulnerability of the individual to majority rule: "Such democracies have ever been spectacles of turbulence and contention; have ever been found incompatible with personal security or the rights of property and have in general been as short in their lives as they have been violent in their deaths" (*Federalist,* Number 10). We do not have to view popular majorities as incurably "factious," "mischievous" "passionate," or selfish, as the founders did. It is a sufficient worry that the awesome powers of government may be abused by selfish majorities. The Constitution itself, by specifically denying some powers to the majority, is evidence that the founders understood that "republican principles" alone could not restrain government.

Yet we must still be concerned with the "general inclination of all mankind" for power (Hobbes) and with the "natural tendency" of political power

"to be abused to promote the particular purposes of the holder" (J.S. Mills). Like Adam Smith, we may acknowledge that our butcher and our baker are benevolent people, but we would still feel more secure if the marketplace were organized so that their self-interest coincided with the public good. So also in government: we may acknowledge that great wisdom resides in the American people and that statesmen frequently pursue the public welfare without regard to personal gain. But we would still feel more secure if government were organized so that official pursuit of self-interest coincided with the public good.

Democratic political processes alone cannot restrain Leviathan. The founders understood that "republican principles," while they should be nurtured and cherished, would not be sufficient in themselves to protect individual liberty. Periodic elections, party competition, voter enfranchisement, and political equality may function to make governing elites more responsive to popular concerns, but these processes do not protect minorities or individuals, "the weaker party or an obnoxious individual," from government deprivations of liberty or property. Indeed "the great object" of constitution writing was to preserve popular government and at the same time to protect individuals from "unjust and interested" majorities. "A dependence on the people is, no doubt, the primary control of government; but experience has taught mankind the necessity of auxiliary precautions" (*Federalist*, Number 51).

"Opposite and Rival Interests"

Among the most important "auxiliary precautions" the founders devised to control government is federalism, which they viewed as a source of constraint on Leviathan. Governments and government officials were seen as likely to act in their own self-interest:

> No man is allowed to be a judge in his own cause, because his interest would certainly bias his judgement, and not improbably, corrupt his integrity. With equal, nay with greater reason, a body of men are unfit to be both judges and parties at the same time; yet what are many of the most important acts of legislation, but so many judicial determinations, not indeed concerning the rights of single persons, but concerning the rights of large bodies of citizens? And what are the different classes of legislators but advocates and parties to the causes which they determine? (*Federalist*, Number 10)

Therefore constitutional arrangements must be devised so that the personal interest of government officials coincides with the interest of society.

The solution to the problem of adjusting the self-interests of government officials to interests of the larger society is competition. Rather than rely on the "better motives" of statesmen, the founders sought to construct a governmental system incorporating the notion of "opposite and rival interests." Governments and government officials can be constrained by competition with other governments and other government officials:

> Ambition must be made to counteract ambition. The interest of the man must be connected with the constitutional rights of the place. It may be a reflection on human nature, that such devices should be necessary to control the abuses of government. But what is government itself, but the greatest of all reflections on human nature? (*Federalist*, Number 51)

Constitutional limits on governmental power do not enforce themselves. Regardless of how explicitly a constitutional protection may be stated in a document, it will not give much protection to individuals unless government officials are provided with personal motives to enforce it. Those motives must be supplied by constitutional arrangements that encourage competition within and among governments. The solutions the founders advanced were federalism and the separation of powers within the national government:

> In the compound republic of America, the power surrendered by the people is first divided between two 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. (*Federalist*, Number 51)

Federalism is the creation of "opposite and rival" interests among governments. Understanding U.S. federalism is recognizing the paramount importance of competition among governments. Federalism is not only competition between the national government and the states, the topic of most modern scholarship and federalism; it is also competition between the states. Indeed, it is also, by extension, competition among the nation's eighty-three thousand local governments. The founders themselves recognized the importance of "the system of each state within that state" as a component of federalism (*Federalist*, Number 33).

Federalism in Search of a Definition

Federalism has fallen on hard times. It has lost its meaning in American politics not only as a result of centralizing tendencies in government but also as a result of the failure of scholars to nourish the idea of it. A survey of contemporary scholarship on the topic concludes that "the theory of federalism has fallen into disrepair" (Beam, Conlan, and Walker, 1983). Indeed, the no-

tion of federalism has fallen on such hard times that some leading scholars have urged its replacement with simple descriptions of "intergovernmental relations" (Wright 1978). Rather than search for a viable analytic or normative model of federalism, it seems easier to provide empirical descriptions of current relationships among national, state, and local governments.

The centralizing forces in the American political system have discouraged all but the most devoted scholars of federalism. Political scientist Daniel Elazar laments:

> We have moved to a system in which it is taken as axiomatic that the federal government shall initiate policies and programs, shall determine their character, shall delegate their administration to the states and localities according to terms that it alone determines, and shall provide for whatever intervention on the part of its administrative agencies as it deems necessary to secure compliance with those terms. . . . Not only has the Constitutional theory of federalism been replaced by a half-baked theory of decentralization, but it is a vulgar and, at times, vicious theory as well. (Elazar 1980, pp. 84–85, 86)

Federalism is not merely a decentralized national government. Although it is undoubtedly true that decentralization makes government more manageable and assists in the implementation of national policy, federalism is not the existence of administrative units of the national government. The states are not "middle managers" (Elazar 1981b).

Federalism is not intergovernmental relations. It is not an effort to achieve cooperation between the national government and state and local governments in carrying out national policy. Regrettably the disciplines of political science and public administration have generally treated federalism as an administrative problem to be overcome in the implementation of national policy. Federalism is equated with efficient government administration, with improving the management of federal programs. But federalism is not an administrative or managerial concept.

Federalism is not representation of state or local units of government in the national government. This is the definition of federalism implicit in the U.S. Supreme Court's *Garcia* decision (1985): a federal system is one in which the legislature of the national government is composed of individuals elected from subnational units of government. There are few governments in the world that are not federal by such a vacuous definition.

State and local governments are political systems, not administrative units of the national government. Their primary function remains political, not managerial. Daniel Elazar has endeavored to preserve our understanding of federalism by stressing the states' role as "polities." Consider his definition of federalism: "The mode of political organization that unites smaller *polities* within an overarching political system by distributing power among general and constituent governments in a manner designed to protect the existence and authority of both national and subnational political systems enabling all to share in the overall system's decision-making and executing processes" (Elazar 1966, p. 2). His key descriptive term for state and local governments is "polities"; the principal task of these units is to govern, not simply administer or manage programs devised by the federal government.

Political scientist Paul E. Peterson has provided an excellent starting place for rebuilding a meaningful notion of federalism: "Federalism is a system of government in which powers are divided between higher and lower levels of government in such a way that both levels have a significant amount of separate and autonomous responsibility for the social and economic welfare of those living within their respective jurisdictions" (Peterson 1981, p. 67). Moreover, says Peterson, the responsibilities of the subnational governments must include, at a minimum, the recruitment of their own political and administrative leaders and the power and responsibility to tax their citizens to provide whatever services their citizens demand. We would add another minimal condition: the autonomy of the subnational governments must be given exceptional legal protection, such as a written constitution that cannot be amended without the consent of both national and subnational populations. In other words, subnational governments cannot be dependent on the national government politically or financially if the system is to retain a genuine federal character.

Federalism must grant some political and financial independence, some responsibility for deciding about policy and paying for these policy decisions, to state and local governments if they are to be truly competitive. These governments must be able to pursue a range of public policies, to provide a variety of public services, and to vary the level of these services. The costs of these policy decisions must be borne by the people in these jurisdictions. State and local governments cannot be truly competitive if the national government determines national priorities and treats state and local governments as administrative units, assigning them responsibilities for policy implementation. Nor can state and local governments be truly competitive if the costs of their decisions can be externalized—shifted to the national government and to taxpayers throughout the nation. Competition requires that voter-taxpayers within states and communities bear the burdens as well as the benefits of their own choices.

Federalism in Search of a Theory

Federalism is a defense against tyranny. The political argument for it centers on preventing the abuse of power. Creating "opposite and rival interests"

within government protects minorities and individuals from abuse by particular governing elites or popular majorities, either within the states or in the nation as a whole. A federal system, with many rival and competitive governments, better protects individual liberty than a single government.

But to defend against tyranny, governments within a federal system, all eighty-three thousand of them, must indeed be rivals. Only a truly competitive federalism offers protection against abusive government. Most of the models of federalism advanced in the scholarly literature of modern political science, either as descriptions of the historical evolution of federalism in the United States or as normative ideals for a federal system, are noncompetitive and offer little protection against tyranny.

Dual Federalism

Consider, for example, the model of dual federalism, which was said to describe federal-state relations during the nation's first hundred years. In this model, states and nation, functioning in the same territory, divide governmental functions. The national government deals exclusively with its enumerated powers in Article I, section 8, principally national defense, international affairs, money and credit, and foreign and interstate commerce, and the states deal with the most important domestic issues, including education, welfare, health, and criminal justice.

This was the founders' understanding of federalism, as evidenced, for example, in Madison's explanation:

> The powers delegated by the proposed Constitution to the federal government are few and defined. Those which are to remain in the State governments are numerous and indefinite. The former will be exercised principally on external objects, as war, peace, negotiation, and foreign commerce; with which last the power of taxation will, for the most part, be connected. The powers reserved to the several States will extend to all objects which, in the ordinary course of affairs, concern the lives, liberties, and properties of the people, and the internal order, improvement, and prosperity of the States. (*Federalist,* Number 45)

Under the federal system contemplated by the Constitution, the states would "form distinct and independent portions of the supremacy, no more subject within their respective spheres to the general authority than the general authority is subject to them within its own sphere" (*Federalist,* Number 39). Even Alexander Hamilton, an ardent spokesman of national power, acknowledged that "the state governments would clearly retain all the rights of sovereignty which they before had, and which were not, by that act, *exclusively* delegated to the United States" (*Federalist,* Number 32). In 1871 the U.S. Supreme Court in *Tarbel's Case* defined American federalism in this same fashion:

> There are within the territorial limits of each state two governments, restricted in their sphere of action, but independent of each other, and supreme within their respective spheres. Each has its separate departments, each has its distinct laws, and each has its own tribunals for their enforcement. Neither government can intrude within the jurisdiction of the other or authorize any interference therein by its judicial officers with the action of the other.

If taken seriously, however, "dual federalism" would prevent competition between the national and state governments. In this "layer cake" model (Grodzins 1966), each level of government would exercise unchecked power in its own policy domain. However, we know that in fact this model never described federal-state relations well. From the earliest days, the national government involved itself in public activities reserved to the states and people (Elazar 1962).

Cooperative Federalism

The model of cooperative federalism, which was said to describe federal-state relations in the first half of the twentieth century, at least allowed for the possibility of federal-state rivalry. This "marble cake" federalism mixed federal and state policy responsibilities: "As the colors are mixed in a marble cake so functions are mixed in the American federal system" (Grodzins 1966, p. 265). Yet even in this model of shared nation-state responsibilities, the normative bias was clearly toward cooperation rather than competition—and the cooperation expected of states and communities was in achieving goals determined by the national government. Congress acknowledged it had no direct constitutional power to regulate public health, safety, or welfare. It therefore relied upon its power to tax and spend for the general welfare to establish a system of financial rewards and punishments—giving or withholding grants-in-aid—in order to achieve national goals. The normative bias of this model was toward cooperation; rivalry or competition from state and local governments was viewed as parochial, backward, unresponsive, or worse.

Centralized Federalism

Centralized federalism drops all pretense to federal, state, and local sharing in policymaking for the nation. When President London B. Johnson launched the Great Society in 1964, the federal government assumed the power to define national problems and set national goals in virtually all areas of public

policy: education, health, and welfare, water and air pollution, consumer safety, home insulation, noise abatement, highway beautification, and even metric conversion. This model of "federalism" is indistinguishable from a centralized government. State and local governments are viewed as administrative instruments of the national government. If flexibility is permitted at all, it is only better to implement national goals in a local environment. Congress legislates directly on whatever matter it chooses, without regard to its enumerated powers and without even pretending to rely on financial incentives. As for the cake analogies, one commentator observed: "The frosting had moved to the top, something like a pineapple upside down cake" (Reese 1979, p. 78).

Liberal scholars rushed to defend this theory of federalism. James Sundquist (1969) of the Brookings Institution explained that "the nation for decades has been steadily coalescing into a national society" (p. 10); "the Great Society is, by definition, one society; the phrase is singular, not plural" (p. 12); and effective governance requires "close federal supervision and control to assure that national purposes are served" (p. 3).

Not much is left of federalism under such a theory, but the proponents of this view still claim the federalism label. Their claim rests on the representational idea: the United States is said to retain a federal system because national officials—the president, through the operation of the electoral college, and the Congress, through the allocation of two Senate seats per state and the appointment of representatives to states based on population—are selected from subunits of government.

Representational Federalism

The U.S. Supreme Court appears to have adopted this notion of "representational federalism." According to the Supreme Court's *Garcia* decision (1985), there are no constitutionally protected powers of the states, no "a priori definitions of state sovereignty," no "discrete limitations on the objects of federal authority," other than the provision granting the states a role in the selection of Congress and the president. (The constitutional provisions specifically dealing with the federal division of powers and with federal representation are shown in table 1–1.) The Court rhetorically endorsed a federal system but left it up to the national Congress, rather than the Constitution or the courts, to decide what powers the states and the national government should exercise. But if federalism is to retained, the Constitution, not the Congress, must divide powers. "The states role in our system of government is a matter of constitutional law, not legislative grace." And the courts must interpret the Constitution, protecting the powers of the states and defining the powers of the national government. In the words of the Supreme Court's dissenting members in *Garcia*, "The extent to which the states may exercise

Table 1–1
Federalism in the Constitution

Guarantees to the States	*Limits on the States*
1. General	
Powers not delegated to the U.S. by Constitution, or prohibited by it to the states, are reserved to the states (Amend. X)	States cannot enter into treaties, alliances, or confederations (Art. I, sec 10)
States cannot be sued by citizens of another state or a foreign nation (Amend. XI)	No separate coinage (Art. I, sec. 10)
No division or consolidation of states without state legislative consent (Art. IV, sec. 2)	No interstate or foreign compacts without congressional consent (Art. I, sec. 10)
Republican form of government (Art. IV, sec. 2)	Constitution, all laws and treaties made under it, to be the supreme law of the land, binding on every state (Art. VI)
Protection against invasion (Art. IV, sec. 2)	Slavery forbidden (Amend. XIII)
Protection against domestic violence on application of proper state authorities (Art. IV, sec. 2)	All state legislative, executive, and judicial officers and state representatives in Congress to be bound by Constitution (Art. IV)
2. Military	
Power to maintain militia and appoint militia officers (Art. I, sec. 8, Amend. II)	No letters of marque and reprisal (Art. I, sec. 10)
	No maintenance of standing military forces in peacetime without congressional consent (Art. I, sec. 10)
	No engagement in war without congressional consent, except for the purpose of repelling invasion (Art. I, sec. 10)
	Congress may provide for organizing, arming, and disciplining the militia when it is not in federal service and for governing it when it is in federal service (Art. I, sec. 8)
3. Commerce, Money, and Taxation	
Equal apportionment of direct federal taxes (Art. I, sec. 2, 9)	No levying of duties on vessels of other states (Art. I, sec. 9)
No federal export duties (Art. I, sec. 9)	No legal tender other than gold or silver (Art. I, sec. 10)
No preferential treatment for ports of one state (Art. I, sec. 9)	No impairment of obligations of contracts (Art. I, sec 10)
Reciprocal full faith and credit among states for public acts, records, and judicial proceedings (Art. IV, sec. 1)	No levying of import or export duties without consent of Congress except the levying of reasonable inspection fees (Art. I, sec. 10)
Reciprocal privileges and immunities for citizens of the several states (Art. IV, sec. 2)	No tonnage duties without congressional consent (Art. I, sec. 10)

Table 1–1 continued

Guarantees to the States	*Limits on the States*
4. Justice	
Federal criminal trials to be held in state where crime was committed (Art. III, sec. 2)	No bills of attainder (Art. I, sec. 10)
Extradition for crimes (Art. IV, sec. 2)	No ex post facto laws (Art. I, sec. 10) Supreme Court has original jurisdiction over all cases in which a state shall be a party (Art. III, sec. 2)
Federal criminal juries to be chosen from state and district in which crime was committed (Amend. VI)	Judges in every state bound by the Constitution and all laws and treaties made under it, notwithstanding the constitutions or laws of any state (Amend. VI)
Federal judicial power to extend to controversies between two or more states, between a state and citizens of another state when state is plaintiff, and between foreign nation or its citizens, with original jurisdiction vested in the Supreme Court (Art. III, sec. 2)	No denial of life, liberty, or property without due process of law (Amend. XIV)
	No denial of equal protection of state laws to person within its limits (Amend. XIV)
	No abridgement of privileges and immunities of U.S. citizens (Amend. XIV)
5. Representation	
Congress	
Members of House of Representatives chosen by voters, those qualified to vote for most numerous house of state legislature in the several states (Art. I, sec. 2)	Representatives must be 25 years old and U.S. citizens for seven years (Art. I, sec. 2)
At time of election, representatives must be inhabitants of states from which they are elected (Art. I, sec, 2)	Senators must be 30 years old and U.S. citizens for nine years (Art. I, sec. 3)
Representatives to be apportioned among the states according to population every ten years (Art. I, sec. 2)	Congress may make or alter regulations as to the times, places, and manner of holding elections for senators and representatives (Art. I, sec. 4)
State executive has authority to fill vacancies (Art. I, sec. 2)	Each house shall be the judge of the elections, returns, and qualifications of its own members, shall punish its members for disorderly behavior, and shall expel a member by two-thirds vote (Art. I, sec. 5)
Each state shall have at least one representative (Art. I, sec. 2)	Basis for appointment of representation in House of Representatives may be reduced proportionate to state deprivation of the right to vote of otherwise qualified citizens (Amend. XIV, sec. 2)
Senate shall be composed of two senators from each state (Art. I, sec. 8) who are chosen by the people qualified to vote for the most numerous house of the state legislature (Amend. XVII), with vacancies to be filled as prescribed by state legislation (Amend. XVII)	Without express consent of two-thirds of Congress, states cannot be represented by persons who have taken an oath to support the Constitution and have since engaged in insurrection (Amend. XIV, sec. 3)
At time of election, senators must be inhabitants of the states from which they are chosen (Art. I, sec. 3)	

Table 1–1 continued

Guarantees to the States	*Limits on the States*
Times, places, and manner of holding elections for senators and representatives shall be prescribed for each state by its legislature (Art. I, sec. 4)	
No state to be deprived of equal representation in the Senate without its consent (Art. V)	
President	
To be selected by the electors of the several states, with each allotted a number of electors equal to the total number of its senators and representatives (Art. II, sec. 1)	Congress may determine the time of choosing electors and a uniform day on which they shall cast their votes (Art. II, sec. 1)
Each state to have one vote if presidential election is decided in House of Representatives (Art. II, sec. 1)	
Approval of presidential appointees by the Senate as Congress shall prescribe (Art. II, sec. 2)	
Amendments to Constitutioin	
Amendments must be ratified by three-fourths of the states (Amend. V)	
Amendments can be proposed by two-thirds of the states (Amend. V)	
Voting	
	on grounds of race, color, or previous condition of servitude (Amend. XV, sec 1)
	Cannot be denied or abridged on account of sex (Amend. XIX, sec. 1)
	No poll tax may be levied as requirement to vote in federal elections (Amend. XXIV)
	Cannot be denied or abridged for citizens 18 years of age or older on account of age (Amend. XXIV)
Foreign Affairs	
Treaties must be ratified by two-thirds of Senate (Art. II, sec. 2)	Treaties binding on states as supreme law of the land (Amend. VI)
Appointment of foreign service officers subject to Senate confirmation (Art. II, sec. 2)	

their authority . . . henceforth is to be determined by political decisions made by members of the federal government, decisions the Court says will not be subjected judicial review. It does not seem to have occurred to the Court that it—an unelected majority of five justices—today rejects almost 200 years of the understanding of the constitutional status of federalism."

Fiscal Federalism

Economists have developed the notion of fiscal federalism based on spatial efficiency in the provision of government goods and services. They have sought to determine which level of government can minimize spillover benefits and costs in the provision of a public service and which level of government can achieve the greatest economy of scale. Thus, fiscal federalism has generally dealt with the assignment of various government functions and sources of revenues to different levels of government. (See, for example, Musgrave 1969 and especially Oates 1972.) These economists acknowledge that decentralization can result in a better fit between citizen demands and public policy, but "if the central government can achieve cost savings by providing a uniform service level across localities, then this must be weighed against the potential welfare gains from diversified local outputs to ascertain the appropriate level of government to provide the service" (Oates 1972, p. 6).

Fiscal federalism models largely ignore the political problem of controlling Leviathan. Creating "opposite and rival interests" within government itself, that is, ensuring competition within and between levels of government, is not the principal concern of the fiscal federalists. On the contrary, by assigning specific governmental functions to a single level of government based on considerations of scale, the fiscal federalists would weaken the most attractive feature of federalism: competition among governments.[1] The fiscal federalists would create government monopolies in various public goods based on their criteria of minimizing externalities and maximizing economies of scale. Wallace Oates describes fiscal federalism: "In this model there is a clear division of functions among levels of government that leads to the attainment of a welfare optimum" (p. vii). Thus the fiscal federalism model leads to a system of government monopolies, not to a competitive system of rival governments.

New Federalism

New federalism models seek to reverse centralizing tendencies in American government, to restore a balance of power between nation and states, to revitalize the powers of state and community governments. According to President Reagan:

> Our citizens feel they have lost control of even the most basic decisions made about the essential services of government, such as schools, welfare, roads, and even garbage collection. They are right. A maze of interlocking jurisdictions and levels of government confronts the average citizen in trying to solve even the simplest of problems. They do not know where to turn to for answers, who to hold accountable, who to praise, who to blame, who to vote for or against. (State of the Union Message, 1982)

The phrase *new federalism* originated in the administration of President Richard M. Nixon, who used it to describe general revenue sharing—the national government's sharing of its own tax revenues with state and local governments with few strings attached. Later President Ronald Reagan used the phrase to describe a series of proposals designed to reduce federal spending for domestic programs and encourage states to undertake greater policy responsibilities themselves.

But these new federalism models do not amount to a coherent theory of federalism—a theory of "opposite and rival interests" as protection against tyranny. On the contrary, they emphasize a division of revenues and responsibilities. They recognize that the national government has grown too large and too intrusive, but they envision a separation of national and state functions rather than competition among state governments and between state and national governments.

None of these models of American federalism gives much attention to competition, either normatively or analytically. Yet fostering competition, creating "rival and competing interests," was the principal concern of the founders in their effort to oblige government "to control itself."

Competitive Federalism as Marketplace

Traditionally political science gave little attention to market solutions to questions of government. Concentrations of political power were not perceived in the same fashion as concentrations of wealth. Centralized government was not explicitly described as a monopoly problem. Yet it is not difficult to view Hobbes's Leviathan as a monopoly problem or to envision competition among rival governments for the voluntary affiliation of freely choosing individuals as the solution.

A market economy depends on voluntary exchange. Individuals choose whether to enter into agreements based on their own calculations of net benefits to themselves. They affect the market both when they enter into agreements and when they decline to do so. Individuals are assumed to act in their own self-interest. Competition stimulates them to offer more to others at lower costs. The combination of personal incentives and competition creates efficiency in society as a whole, raising output and lowering costs. The market process works best when there are many buyers and sellers, freedom of entry and exit, good information, and protection of private property. Markets maximize individual choice, rely on voluntary exchange rather than coercion, and provide personal incentives for societal progress.

Competitive federalism envisions a marketplace for governments where consumer-taxpayers can voluntarily choose the public goods and service they prefer, at the cost they wish to pay, by locating in the governmental jurisdiction that best fits their policy preferences. In this model of federalism, state and local governments compete for consumer-taxpayers by offering the best array of public goods and services at the lowest possible costs. The preferences of all individuals in society are better met in a system of multiple governments offering different packages of services and costs than of a single monopoly government, even a democratic one, offering a single package reflecting the preferences of the majority. The greater number of governments to select from, and the greater the variance in public policies among them, the closer each consumer-taxpayer can come to realizing his or her own preferences.

Matching public policy to citizen preferences is the essence of responsive government. Competitive elections and political parties were designed to achieve this goal. But decentralized government is also a way to match citizen preferences with public policies. Given variation in policy preferences across the nation and given independent governments with the authority to offer a wide range of policies at different costs, a truly federal government can achieve a far better match between preferences and policies than a centralized government imposing uniform policies throughout the nation.

Competitive federalism forces governments to improve services and reduce costs, that is, to become efficient. It forces governments to make better estimates of citizen preferences for public goods. Indeed, it provides a market solution to the problem of accurately assessing the demand for public goods. The ability of government to know the true demand for public goods is perceived by many market-oriented economists as the core problem of government. The absence of a market and a price system makes information about the true value of government activities difficult to assess. But competition among governments, offering different types and levels of public goods at different costs, provides a rough market solution to the information problems confronting public officials.

Competition in the private marketplace forces sellers to become sensitive to preferences of consumers. Competition among governments forces public officials to become sensitive to the preferences of citizens. Lessened competition in the marketplace results in higher prices, reduced output, and greater inefficiency in production. Lessened competition among governments results in higher taxes, poorer performance, and greater inefficiencies in the public sector. Competition in the marketplace promotes discoveries of new products. Competition among governments promotes policy innovation.

Competitive federalism, viewed as a marketplace model, is an extension of the "pure theory of local expenditures" described by economist Charles M. Tiebout many years ago (Tiebout 1956). Automobiles and expressways had only recently extended the mobility of significant segments of the metropolitan population. The Tiebout model was designed for local governments and metropolitan locational decisions. According to Tiebout, "The consumer voter may be viewed as picking that community which best satisfies his preference pattern for public goods. This is a major differences between central and local provision of public goods. . . . The consumer-voter moves to that community whose local government best satisfies his set of preferences. . . . The greater the number of communities and the greater the variance among them, the closer the consumer will come to fully realizing his preference position" (p. 418). The Tiebout model not only better satisfies the preferences of consumer-taxpayers; it also forces local governments to compete and thereby become more efficient. "On the production side it is assumed that communities are forced to keep production costs at a minimum either through the efficiency of city managers or through competition from other communities" (p. 422).

Mobility

According to Tiebout, the assumption of mobility is critical to the marketplace model: "The act of moving or failing to move is crucial. Moving or failing to move replaces the usual market test of willingness to buy a good and reveals the consumer-voter's demand for public services" (p. 420). "Spatial mobility provides the local public-goods counterpart to the private market's shopping trip" (p. 422).

The mobility assumption is often viewed as the weakness of the Tiebout model. It is more difficult to "shop" from one municipality, school district, or state to another than it is to go from store to store in search of bargains. But Americans are the most mobile people in the world, and mobility is much

greater today than when Tiebout constructed his model. Between 1980 and 1985, 40 percent of Americans moved their residences, and nearly 10 percent moved to a different state. Family mobility is important; families are consumer-taxpayers. But perhaps even more important is the mobility of capital investment. Business and industry are also consumer-taxpayers, and there are many reasons to believe that industry and capital are more mobile today than at any other time in the nation's history. Heavy industry, with bulky raw materials and finished products, is dependent upon water and rail transportation. But heavy industry has been replaced by light industry as the driving force in the American economy. And light industry—high-tech enterprise, trade and services, and finance and administration—is much more mobile. As transportation and communication systems have improved, mobility has increased. Thus, capital as well as labor, people as well as enterprise, are increasingly mobile.

The competitive federalism model does not require that every household or firm in the United States be prepared to move in response to government policy change. That is a caricature of the model. Markets are determined by the actions of marginal buyers and sellers. All that is required is that a significant number of households and firms, families and business, and investment capital be mobile and responsive to government policies.

Information

Information is even more critical than mobility to the competitive government model. Here we diverge somewhat from the emphasis Tiebout placed on mobility. Multiple governments offering a range of public services at various costs provide comparative information to both officials and taxpayers about government services and their costs. This information itself is valuable because it enables citizens to compare governmental performances. Citizens are not only consumer-taxpayers; they are also voters and as such can exert influence on their own governments to match or exceed the performance of other governments.

The amount of information now available to people and firms, and the speed with which the information reaches them, is vastly greater than only a few decades ago. Again, not all voters must have information about the performance of governments in other jurisdictions in order to influence public officials. Governments respond to small attentive publics, and many public officials may welcome comparative information on public services and costs in other cities and states.

Competitive federalism offers dissatisfied citizens two separate options when they find themselves in a minority position on policy issues. These options correspond to traditional market and political responses to dissatisfaction. Market models rely on the exit response (Hirschman 1970). Dissatisfied consumers of certain products cease buying them and find other products in the marketplace; dissatisfied employees quit their jobs and find employment elsewhere. But democratic governments offer another option to dissatisfied citizens, that of voice. Citizen-voters can complain and threaten elected officeholders with ouster. (Actually, the voice and exit mechanisms are available in both government and private markets. Exit may be more commonplace in the private market, but dissatisfied consumers sometimes complain to business and demand refunds. Voice may be more commonplace in government, but dissatisfied citizens sometimes do withdraw their children from public school or move to states with lower taxes.) The combination of exit and voice responses strengthens the power of citizens in relation to their government. The exit responses provide the "auxiliary precaution" against tyranny that the founders sought to provide through federalism.

Dealing with Externalities, Especially Welfare

Markets are limited in the types of goods and services they can provide. Indeed, even in a free market economy it is recognized that some public goods cannot be supplied by markets but must instead be supplied by governments. Public goods are defined as services, activities, or functions that are nonexclusive; once they are provided to anyone, no one can be excluded from their benefits. The nonexclusive character of public goods recognizes the free-rider problem: these goods cannot be provided on the free market because nonbuyers would benefit just as much as buyers even through the nonbuyers paid none of the costs. National defense is the familiar example of a public good. Once it is provided, it is provided for all; it cannot be provided by the market because nonbuyers would free ride on the purchases of buyers.

The logic of public goods can be extended to federalism. In a system of multiple competing governments, the free-rider problem inhibits governments from providing a nonexclusive service—one that citizens in their jurisdictions could benefit from without paying the cost. Some governments would let other governments provide the nonexclusive service, encouraging their own citizens to consume it without contributing to its costs. The providing governments would soon be dissuaded from offering the service at all as their own citizens observe the free-riding beneficiaries pouring into their jurisdiction and confront costs not borne by citizens of other jurisdictions.

It is frequently argued that state and local governments, in a competitive environment in which citizen-taxpayers can move freely from one jurisdiction to another, cannot provide adequate welfare services. The reasoning is that any government that raises welfare benefits may be flooded with poor people

fleeing more miserly jurisdictions, which would free ride on the compassionate decision of their neighbor. Moreover, the increased taxes required to pay for higher welfare benefits might encourage affluent citizens and business to relocate to jurisdictions that did not impose these welfare burdens. Thus, competition among governments might result in the underprovision of welfare services.

It is certainly true that the principles of efficiency and equity are frequently in conflict in political and economic affairs (cf. Okun 1975). Competitive federalism may involve some trade offs between these values: protection against tyranny and the overall satisfaction of individual preferences versus the underproduction of welfare services. The political and economic benefits of competitive federalism may come at the costs of some equity considerations. If this is true, it should not necessarily doom the idea; society makes many such trade-offs. Indeed it is frequently argued that our society has traded off efficiency in so many of its redistributional programs that it threatens to impoverish both rich and poor. But let us examine the equity effects of competitive federalism more closely. Perhaps it does not require a trade-off of equity after all. Perhaps the poor will benefit from competitive federalism or at least not be adversely affected by it.

The reason that efficiency and equity principles are generally perceived as conflicting is that efficiency is seen in a very narrow sense. That is, individuals, families, and firms are seen as exclusively motivated by monetary benefits to themselves and exclusively interested in their own material well-being. But this assumption—*homo economicus*—does not describe many of us. Our personal "utility functions" more often include some concerns for the well-being of our fellow citizens. We feel better when others are ensured of a decent existence—some minimum standards of nutrition, housing, health care, education, and other necessities of life. We are even willing to pay some portion of our own incomes, reducing our own consumption, in order to mitigate the suffering of others. A comprehensive assessment of the preferences of consumer-voters must include their equity preferences.

If the welfare policies of the national or state governments depended exclusively on the voting power of the poor, there would be very few welfare services in the United States. Welfare policies in the United States are primarily an expression of the equity preferences of middle-class Americans, not a response to the demands of the poor themselves. Indeed, when we examine the welfare policies of the states in chapter 2, we will find that the states with the greatest numbers and percentages of poor people provide the least in the way of welfare services. The states with the most generous welfare programs, in both absolute terms and in proportion to their incomes, are those with the larger personal incomes. The most important determinant of public welfare benefit levels is the income level of the population (Dye 1966). Our equity

preferences increase with increases in personal income. It is better to be poor in a rich state than in a poor one.

If multiple competing governments are seeking to maximize the true preferences of consumer-taxpayers, they must do so in the provision of welfare services as well as any other public goods. Compassionate welfare policies will attract middle-class families and wealthy firms. Is it reasonable to assume that migrating families and firms would wish to locate in areas of squalor, poverty, homelessness, and human degradation simply to avoid the costs of welfare services? The cross-sectional evidence—that wealthy states provide more welfare service than poorer states—suggests that welfare services are preferred by many middle-class residents and wealthy firms.

The view that competitive federalism would result in the underproduction of welfare services rests largely on the belief that the poor will migrate to the most generous jurisdictions. But the poor are the least mobile segments of society. Whatever their impact on state welfare services, it is certainly less than the impact of mobile upper-middle-class Americans and wealthy firms. Under competitive federalism, the most mobile sectors of the population and the economy exercise the greatest influence over public policy. But there is convincing evidence that these affluent segments of the population are more likely to support welfare services than society generally.

In short, competitive federalism tends to ensure policy responsiveness. Admittedly, it is not designed to maximize equity, that is, to encourage redistributional policies. But the preferences of consumer-taxpayers are not necessarily narrow and selfish. Competitive federalism ensures responsiveness to redistributional preferences, as well as other policy preferences.

Competitive Federalism and Responsive Government

Competitive governments ought to be more responsive than monopoly government to citizen preferences. Democracy itself, with competing parties and periodic free elections, is a powerful inducement to policy responsiveness, at least to majority policy preferences, even in a monopoly government. But if multiple governments are both democratic and competitive, citizens have two separate mechanisms to help achieve congruence between their preferences and public policy. If people can "vote with their feet," as well as cast ballots in contested elections, they have two separate potential responses to policies they do not like. Elections offer people periodic opportunities to change governmental leadership and public policy as well. Moving to rival cities or states offers people the continuing opportunity to choose alternative policies. Individuals with differing policy preferences can choose to live in states and com-

munities where policies most closely match their preferences. Rival cities and states, realizing that people can choose among them, are forced to be sensitive to the preferences of mobile consumer-taxpayers. Thus, competitive federalism ensures responsive government and a closer match between citizen preferences and public policy.

Competitive federalism depends upon state and community governments' providing different packages of services and taxes. These governments must not be coerced or bribed by the national government into policy uniformity. There is no real competition, and hence no true responsiveness to individual preferences, if state and local governments are not free to pursue a wide range of policies. Policy variation among government is a requirement for genuine competitive federalism.

Competitive Federalism and Policy Innovation

Traditional defense of federalism frequently cited the opportunity it provides for policy experimentation. According to this argument, states can serve as laboratories where solutions to public problems can be tried and tested. Policy innovation and initiative are encouraged by federalism.

Federalism may be perceived today as a conservative idea, but it was once viewed as the instrument of progressivism. A strong argument can be made that the groundwork for the New Deal was built in state policy experimentation during the progressive era. Federal programs as diverse as the income tax, unemployment compensation, countercyclical public works, social security, wage and hour legislation, bank deposit insurance, and food stamps all had antecedents at the state level. Indeed, much of the current neoliberal agenda—mandatory health insurance for workers, child care programs, notification of plant closings, government support of industrial research and development—has been embraced by various states. Indeed, the compelling phrase "laboratories of democracies" is generally attributed to the great progressive jurist, Supreme Court justice Louis D. Brandeis, who used it in defense of state experimentation with new solutions to social and economic problems (Osborne 1988, p. 2). But the states cannot serve as laboratories, and the innovative potential of federalism cannot be realized if the states are not free to pursue a wide range of policies.

Competition is the driving force behind innovation. This is true in government as in the marketplace. Just as economists are becoming increasingly aware of the central role of the innovative entrepreneur in the creation of wealth (Brenner 1987), political scientists must understand that intergovernmental competition inspires policy innovation. The politician is an entrepreneur. We know that competition for public office inspires the search for new policy proposals. But competition among governments provides additional

incentives for inventiveness and innovation in public policy. Yet intergovernmental policy competition is more responsible and restrained than electorial competition.

Competition among governments, like competition in the marketplace, produces a rough policy equilibrium. That is, states and cities will be restrained by competition from pursuing policies that diverge sharply from the national policy "market." We might borrow a metaphor from political scientist John Shannon, who portrayed the fifty states as a naval convoy:

> If a state moves out too far ahead of the convoy on the tax side, it becomes increasingly vulnerable to tax evasion, taxpayer revolts and, most importantly, to tax competition for jobs and investments from other states. If a state-local system lags too far behind the convoy on the public spending side, it becomes increasingly vulnerable to quality of life and economic development concerns—poor schools, poor roads, and inadequate support for high-tech operations. (Shannon 1987, p. 4)

The metaphor can be extended beyond tax and spending policies to virtually any other major policy arena. Competition encompasses both dynamic and stabilizing forces.

Competitive Federalism: Checking Government Growth

Restraining Leviathan is a problem of checking its growth as well as controlling its power. Governments insufficiently constrained will grow very large. Competitive federalism promises a potential constraint on the growth of government.

Governmental growth may not always represent the true preferences of citizen-taxpayers. Many explanations of growth focus on the oversupply of public goods and services originating from the imperfections of political processes. Governments may grow in response to the accumulated demands of interest groups, each of which seeks a concentrated benefit for itself knowing that its costs can be diffused throughout society (Downs 1957; Buchanan and Tullock 1962; Lewis-Beck and Rice 1985). Government may grow as a result of bureaucratic expansionism (Niskanen 1971), as well as the persistent demands of public employees backed up by the exercise of their vote (Buchanan and Wagner 1977). Government may grow because citizens can discount the future costs of public goods and services through deficit spending. Citizens may demand more public services because of the "illusions" of low costs created by withholding taxes and indirect taxes (Buchanan and Wagner 1977). Governments may grow because of productivity lags in public sector

(Baumol 1967) and the cumulative unintentional consequences of past policy decision (Wildavsky 1964).

Determining the optimal size of government—the level of public goods and services that best fits the preferences of all individuals in society—is a difficult task, both theoretically and practically. Indeed, we do not even know whether conventional measures of the size of government—such as total government expenditures as a percentage of the gross national product—actually measure the costs imposed on society by government activity. Regulatory activity prevents people from doing what they otherwise would do and thus imposes costs on society. Yet these costs are unmeasured by conventional taxing and spending figures.

Public sector economics (e.g., Haveman 1970) posits the "maximum social gain" rule for determining public sector activity: Governments should chose policies which result in gains to society which exceed costs by the greatest amount, and governments should refrain from policies if costs are not exceeded by gains. Let us agree on the principle itself: no policy should be adopted if its costs exceed its benefits, and in choosing policy alternatives, officials should opt for the one that produces the greatest benefit over costs. Let us even accept its many assumptions: policymakers are motivated to make decision on the basis of maximum societal benefits and minimum societal costs. Policymakers are rational, as well as farsighted, public spirited, and comprehensive in their judgment. They are not distracted by elections, party competition, interest group pressures, bureaucratic lobbying, or narrow self-interests. Let us assume public officials want to do what is right.

Government and public officials still lack the information necessary to implement the maximum social gain rule for determining public sector size. If they err, it is not their fault. They have no way of knowing every individual's preferences. They have no accurate mechanism for weighing these preferences, for finding the preferred balance between benefits and costs, for estimating the equilibrium level of government activity.

Markets provide this information to producers of private goods and services. Despite many imperfections, markets make known to producers the preferences of consumers. Price movements signal their tastes, the intensities of their desires, and their willingness to sacrifice all other goods for any particular product. The market records this information continuously—whenever people choose to buy goods and when they choose not to do so. The market mechanism ensures that goods will not be produced if their costs exceed their value to society.

Competitive federalism, insofar as it creates a "marketplace" for government goods and services, provides a rough informative guide to the true preferences of citizens for government activity. It allows officials and voters to compare governmental performances by observing the services that are offered, and their costs, in various states and communities. This comparative

information is valuable itself, but the potential mobility of citizens gives the system its driving force. Consumer-taxpayers have the opportunity to register their policy preferences by moving into or out of government jurisdictions or simply staying put. Governments and their officials can watch the growth of their states and communities—the movement of people, labor, enterprise, capital, and wealth. States and communities that become more productive over time signal to decision makers that their policy packages are preferred. A loss of people and capital over time—a decline in productivity and income, a loss of jobs, and a decline in the revenues of government—signal decision makers that they should search for alternative government policies.

Admittedly, the information conveyed to state and local government officials by these population and economic changes is imperfect. Moreover, government policies are only one of the many potential influences on the movement of people, jobs, industry, and investments. Nevertheless, some information is better than none. Monopoly government receives little information about the preferences of consumer-taxpayers beyond that provided by the electoral process. Competitive governments receive information from both the electoral processes and the movement of families and firms.

It is our argument that competitive federalism provides additional sources of information to decision makers about the true preferences of citizens. If public goods and services are oversupplied by public officials, then competitive federalism can provide a check against excessive government. It is sometimes argued, of course, that government goods and services are not in oversupply. "Perhaps, after all, Leviathan is a mythical beast" (Oates 1985). Competition promises only to make governments more responsive to the preferences of consumer-taxpayers. It can be expected to reduce the size of government only if monopoly government has in fact been oversupplying public goods and services. Competitive federalism is really only a check against the *potential* for excessive government. Competitive federalism introduces the discipline of the marketplace to government decision making.

Incentives for Government to Compete

A viable theory of competitive federalism must set forth some reasons why states and communities might be expected to compete among themselves. What are the incentives to governmental competition?

States and communities—their citizens as well as their leaders—benefit economically from the inflow of resources: labor, capital, and technology. Jobs, income, homes, businesses, and the amenities of life, all derive from economic productivity.

The nation's economic resources—its "factors of production"—are increasingly mobile. Indeed, labor, capital, and technology are increasingly mo-

bile worldwide. These resources are controlled by large national and multinational institutions: industrial corporations, banks, insurance companies, investment firms, and national governments.

But there is one factor of production—land—which is not mobile. It stays in one geographical location. Land is a valuable resource, a necessary factor of production. Capital must be placed somewhere. Labor and technology must be located somewhere. People and industry can come and go, but land stays in particular states and communities.

State and local economic elites have strong financial incentives to try to attract labor and capital to their areas. Capital investment raises land values, expands the labor force, and generates demand for housing and commercial services. Corporate plants and offices, federal civilian and defense facilities, and universities and colleges contribute to increased land values—not only on the parcels these facilities use but also on neighboring parcels. Mortgage lending banks, real estate developers, builders, and landowners are direct beneficiaries of decisions to locate in their communities. They are usually joined by local utilities, commercial establishments, communications media, attorneys, and other professionals, whose business volume is expected to increase.

Masses as well as elites benefit from economic growth. Growth creates jobs and incomes. The export industries may bring with them a substantial portion of their own educated, technically trained work force, thereby limiting the number of new job openings for the local work force. But more important for most prior residents, new industries create jobs in the local economy—in construction, housing, transportation, trade, and service sectors. The multiplier effect of export industry investment affects employment as well as income.

Governments also have direct incentives to try to attract investment to their communities. State and local government elites generally understand that their powers and functions depend primarily on local fiscal resources. Growth in local budgets and public employment, as well as governmental services, depends upon growth in local economy. Governmental growth expands the power, prestige, status, and often the salary of government officials. It is true that federal revenues tend to diminish these ties; one-sixth of all state and local government revenue comes from the federal government. But taxes from local sources and charges for local services remain the major sources of funding for state and local governments. These revenue sources depend on the economic prosperity of the state and community. The most important determinant of the level of government activity in states and communities is their level of economic development (Dye 1966). Thus, if governments or governmental elites behave as rational actors, they will seek to maximize economic resources within their jurisdictions because these resources form the support base for their governmental powers.

State and local communities, then, can be expected to compete to add to their wealth by making their jurisdictions attractive to productive workers, entrepreneurs, and capital investors. "Quite apart from any effects of economic prosperity on governmental revenues or local voting behavior, it is quite reasonable to posit that local governments are primarily interested in maintaining the economic vitality of the area for which they are responsible" (Peterson 1981, p. 291). Thus we are encouraged to believe that states and communities themselves, apart from the specific interests of individual and groups within them, have a general interest in maintaining and increasing their aggregate economic well-being.

Opposition to Economic Growth

There will be many consumer-taxpayers in various states and communities who will oppose additional economic growth. No-growth movements (or to use the current euphemism, growth-management movements) are found in many localities.

There are good theoretical reasons for expecting some opposition to growth. Tiebout argues that "the preferences of the older residents of the community" may support an optimum city size—the population for which public services can be produced at the lowest average cost. This implies that there are some scarce resources in a state or community, perhaps open land, green space, clean air or water, that are fixed. "Communities below the optimum size seek to attract new residents to lower average costs. Those above optimum size do just the opposite. Those at an optimum try to keep their populations constant." (Tiebout 1956, p. 420.) Perhaps Tiebout's focus on the dollar costs of city services makes his analysis appear implausible; few states or cities consciously strive for lower average cost of public goods. But if we think of public goods as environmental amenities—quiet streets, free-flowing traffic, natural beauty, trees, and so on—then we can more easily visualize an optimal size.

Indeed, it has become fashionable in upper-middle-class circles to complain loudly about the problems created by growth: congestion, pollution, noise, unsightly development, the replacement of green spaces with concrete slabs. People who own their houses and do not intend to sell them, people whose jobs are secure in government bureaucracies or tenured professorships, people who may be displaced from their homes and neighborhoods by new facilities, people who see no direct benefit to themselves from growth, and business or industries that fear the new competition that growth may bring to the community combine to form a potentially powerful counterelite.

No-growth movements are not mass movements. They do not express

the aspirations of workers for jobs or renters for their own homes. Instead they reflect upper-middle-class aesthetic preferences—the preferences of educated, affluent, articulate home owners. Growth brings ugly factories, cheap commercial outlets, hamburger stands, fried chicken franchises, and "undesirable" residents. Even if new business or industry would help to hold down local taxes, these affluent citizens would still oppose it. They would rather pay the higher taxes associated with no growth than change the appearance or life-style of their community. They have secure jobs and own their homes; they are relatively unconcerned about creating jobs or building homes for less affluent citizens.

The great advantage of multiple governments and mobile people is the opportunity provided to discontented consumer-taxpayers. Competitive federalism focuses attention on the preferences of potentially migrating consumer-taxpayers. It stresses the exit option. This contrasts with political models that focus on the preferences of the median voter. These models portray the voice option. Competitive federalism is concerned with people who vote with their feet, as well as those who vote with ballots.

Rules and Referees

Competition is not anarchy; it is restrained, disciplined, orderly behavior. Just as the marketplace requires rules—protection of property rights, enforcement of contracts, recognized rules of exchange, and a stable monetary system—so also intergovernmental competition requires rules.

Without question the most important limits on government activity are the guarantees of individual liberty provided by the U.S. Constitution. Over the years the United States has fashioned a national system of civil rights through (1) U.S. Supreme Court decisions under the Fourteenth Amendment extending the Bill of Rights to protection against state and local government infringements, (2) Court decisions guaranteeing due process and equal protection of the laws, and (3) congressional acts prohibiting discrimination in voting, employment, education, housing, and public life. All governments—national, state, and local—are obliged to enforce constitutional liberties. The national government has the special responsibility for implementing the most basic of all mandates in the U.S. Constitution: "This Constitution and the laws of the United States which shall be made in pursuance thereof . . . shall be the Supreme Law of the Land . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding" (Art. VI).

Federalism has a dark history to overcome. For nearly two hundred years, states' rights have been asserted to protect slavery, segregation, and discrimination. This history casts a shadow over any effort to defend state or

local government autonomy and responsibility. Indeed, only now that a national system of constitutional and legal guarantees of personal liberty and equal protection of the law is in place is it possible to reassert the values of the federal system. Having established that federalism will not be allowed to protect violations of personal liberty and dignity, we are now free to explore fully the true merits of decentralized competitive government. Those who wish well for the notion of federalism must endeavor above all else to ensure that it never again becomes a cover for depriving Americans of their personal liberties.

The nation's founders were acutely aware that interstate competition must be restrained. Indeed, the Constitutional Convention of 1787 was inspired in part by a desire to limit interstate rivalry. Alexander Hamilton worried that the states "if disunited" might "make war upon each other" (*Federalist*, Number 7). He was especially concerned with conflicts over western territories, commercial competition, and disputes over state shares of the public debt. So the Constitution itself set forth a series of basic rules of competition among the states:

1. No state shall "lay any Imposts or Duties on Imports or Exports" (Art. I, sec. 10). The creation of a common market prevents trade barriers and guarantees mobility of products.
2. No state shall "coin money" or "emit Bills of Credit" (Art. I, sec. 10). A uniform monetary system facilitates trade and capital mobility.
3. No state shall pass any "Law impairing the Obligation of Contract" (Art. I, sec. 10). The intent was to guarantee that all states would protect private property, enforce contracts, and thus provide the constitutional framework for a free enterprise system.
4. Congress is given the power to "regulate Commerce with foreign Nations and among the several States" (Art. I, sec. 8). While the interstate commerce clause is phrased in terms of power given to Congress, it also been interpreted to restrict states in burdening interstate commerce.
5. States must give "Full Faith and Credit . . . to the public Acts, Records, and judicial Proceedings of every other State" (Art. IV, sec. 1). The full faith and credit clause seeks to ensure legal comity among the states and thus facilitate the mobility of people and business.
6. "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizen in the several States" (Art. IV, sec. 2). The privileges and immunities clause is designed to prevent state discrimination against citizens of other states and thus facilitate personal mobility.
7. The jurisdiction of the federal courts is extended "to controversies between two or more states" and "between citizens of different states" (Art.

III, sec. 2). The federal court system is designated as the arbiter of disputes between states.

8. No state shall "engage in War, unless actually invaded," either with another state or a foreign power, without the consent of Congress (Art. I, sec. 10). States are not supposed to make war on each other, although they did so from 1861 to 1865. They are supposed to resolve their disputes through the federal court system.

Because these rules have been in effect for two hundred years, it is easy for Americans to overlook their importance. However, consider the difficulties that independent nations encounter because these rules are not in effect. Tariff barriers, trade wars, currency restrictions, threats to nationalize private property, restrictions on personal travel, witless bureaucratic interventions, human rights violations—all combine to thwart human enterprise worldwide. It is a tribute to the wisdom of our constitutional forbears that they sought to establish rules of competition among united states.

Rules require referees. The supremacy clause of the Constitution is the heart of the document; it makes the federal court system the ultimate referee in the American federal system. Under Chief Justice John Marshall, who presided over the Supreme Court from 1801 to 1835, the Court assumed the role of the interpreter of the Constitution and arbiter in disputes between states and nation. Federal courts have struck down fewer than one hundred congressional enactments in two centuries, but uncounted thousands of state and local enactments have been voided under federal judicial review.

Unquestionably a strong federal court system is required to make intergovernmental competition restrained and workable. But the fact that the ultimate referee in disputes between states and the national government has been the national Supreme Court has had a profound effect on federalism. Since the Court is a national institution, one might say that in disputes between nation and states, one of the members of the contending teams is also serving as umpire. Only a very strong tradition of adherence to the original intent of the Constitution by the Supreme Court would have avoided the bias toward centralization inherent in such an arrangement. And regrettably the Supreme Court has explicitly rejected the original constitutional formulation of federalism (*Gracia* v. *San Antonio Metropolitan Transit Authority*, 1985). However, the Supreme Court, and the federal court system generally, have been much more willing to retain the rules of interstate competition—to remove barriers to mobility, to remove restrictions on interstate commerce, and to guarantee all persons due process and equal protection of the law wherever they go in the United States.

No Model Is Perfect

Eighty thousand governments are better than one. Multiple competitive governments more closely approximate citizen preferences than monopoly government. Nonetheless, there are serious obstacles to an ideal market for government goods, where citizens can purchase their desired public services at costs they wish to pay. Competitive federalism may resemble a marketplace, but it fails to achieve the efficiency of a market for several reasons.

First, state and local government are themselves monopolies within their respective jurisdictions. Citizens living within specific jurisdictions cannot choose which government services to purchase and which taxes to pay. Government services—education, health, welfare, streets and highways, parks and recreation, police and fire protection—cannot be tailored to suit the tastes of every consumer-taxpayer. These services are, after all, public goods—goods that cannot be provided to some without being provided to others. Otherwise these goods would be marketed in the same fashion as private goods. In a private supermarket, shoppers can fill their baskets with the goods they want. In the government marketplace, mobile citizens and firms must choose between market baskets of public goods that are already full. No two households can be expected to have the same preferences for government services. Even if people migrate to jurisdictions with like-minded citizens, there will still be significant differences in preferences for public policies among these people—differences over levels of public services and taxes, the desired mix of services (for example, education versus welfare versus public safety) at any given tax level, and specific issues within policy areas (for example, whether schools should undertake sex education or whether health programs should include abortion counseling). Not everyone's policy preferences can be completely satisfied, even with multiple governments and varied public policies.

Moreover, government cannot vary taxes according to the amount of public services particular individuals, households, or businesses consume. Constitutionally, taxes must be uniform. This means that individuals or businesses with the same incomes, the same consumption patterns, the same properties, should pay the same taxes. Although state and local government tax codes, like the federal tax code, are filled with special treatments, privileges, and exemptions, nonetheless, some people who pay equal taxes will not benefit equally from government services. Government user charges offer a potential remedy to this mismatch of benefits and burdens, and they are growing as a proportion of total state and local government revenue. But some public goods cannot be provided on a user charge basis; not every street

can have a toll booth. Some people will always be paying for services they do not consume.

These "failures" of state and local governments mean that every consumer-taxpayer will pay for some public service he or she does not want and at the same time will be denied some other public services he or she would be willing to pay for. But this is a problem confronting all governments; it a problem in the provision of public goods at any level. This problem, which economists recognize as an "efficiency" problem, is worse when all consumer-taxpayers are lumped together under a single monopoly government. Multiple competing governments with varied public policies provide opportunities for more closely matching the preferences of citizens with the policies of government.

Finally, mobility is not cost free. Families, businesses, and investors must consider the costs of searching for and moving to a state and community that more closely matches their preferences. If these costs—information and mobility costs— exceed the differences in value between the jurisdiction in which one is already residing and any other jurisdiction, then it is rational to stay put and tolerate unfavorable policies. The higher are the costs of information and mobility in the American federal system, the more people will be obliged to tolerate unfavorable government policies, the higher the ratio of costs to benefits people will be forced to bear, and the less efficient state and local governments will become. The benefits of competitive federalism will be minimal if the costs of migration are high.

Thus, like the simple model of the private economy after which it is fashioned, the competitive federalism model relies on a series of assumptions that are only partially realized in the world. It assumes that state and local governments have a significant and autonomous responsibility for the welfare of the people living in their jurisdiction. It assumes that these governments are free to pursue a range of public policies, to provide a variety of public services, and to vary the level of these services. The model assumes that the costs of government goods and services provided by states and communities are fully reflected in the revenues collected from their residents. To the extent that the national government restricts the policies of state and local governments or offsets the costs of the goods and services they offer by intergovernmental transfers, the model's assumptions are violated.

The model also assumes that there are few externalities associated with the policy responsibilities assigned to state and local governments. It assumes that there is no collusion among state and local governments, no attempt to restrain competition. To the extent that state or local government officials form cartels and enter into agreements to restrict competition or seek federal regulations prohibiting interstate competition, they violate the assumptions of the model.

The model assumes that consumer-taxpayers are mobile, that they have information about the policies and public services of governments, and that they employ this information in their locational decisions. Competitive federalism depends on the behavior of the potentially migrating consumer-taxpayer. State and local government policies in the competitive federalism model would be shaped by the preferences of the mobile segments of the populations and the economy. Yet we know that not everyone is mobile, not everyone knows about the policies of governments, and even among knowledgeable and mobile people and businesses, the policies of government may not rank very high in their locational priorities.

In short, the assumptions of our model are seldom fully met in the American federal system. But such an observation does not destroy the utility of the competitive federalism model itself anymore than the market model is rendered useless by observing externalities, monopolies, immobilities, and imperfect information in real markets. Models are useful when they succeed in directing attention to real-world conditions that obstruct their functioning. An "unrealistic" model is useful when it make us realize how far real-world conditions deviate from the model.

In Search of Competitive Federalism

Competitive federalism, like any other analytic model, is an abstraction or representation of a governmental system. Its purpose is to order and simplify the real world of government and politics so that we can think about it more clearly. It should identify significant characteristics of government and suggest relationships between these characteristics and their consequences. It need not be fully congruent with the real world of government, but it must have some empirical referents. It must be able to direct our inquiries and research into government. If a model's assumptions are unrealistic, if its postulated relationships are totally untestable, then it is not useful for analysis or prescription.

This book will explore many of the assumptions and propositions of the competitive federalism model. We do not intend to prove the model, validate all of its assumptions, or demonstrate its superiority to any other model of government. Rather we intend to examine American state and local government over the past three decades to learn whether the assumptions and propositions of this model have any empirical referents. We hope to identify both the strengths and weaknesses of the model in the American federal system. We want to specify the obstacles to the functioning of the model, as well as the conditions facilitating its operation.

We expect to show, first, that American state and local governments com-

prise a significant segment of our political economy; it is worthwhile to consider how these governments are structured, what they do, why they do it, and what difference it makes to us. More important for the competitive federalism model, we expect to show that these governments are responsive to the demands of their consumer-taxpayers (chapter 2). They expand and contract in response to identifiabe demands. We are especially interested in the contraction of the state and local government sector because we believe that contraction is evidence of responsiveness to citizens' demands. In the case of the national government, we can never know whether its relentless expansion is a product of citizen demand or bureaucratic expansionism, interest group effects, fiscal illusion, or other supply factors. But when governments contract and their contraction is related to an identifiable reduction in the demand for a government service, we are in a better position to infer that these governments are indeed responsive to public demands.

We expect to show that American state and local governments offer a wide variety of public policies, a greatly varied mix of public benefits, costs, and burdens. It is true that the economy is becoming "nationalized"—that income, employment, and investment levels are becoming more equal among the states over time. Even political life is becoming nationalized in the sense that differences among the states in party competition and voter participation are declining over time. But we expect to show that policy differences among the state are not diminishing; rather, differences among the states in the benefits of education, welfare, health, highways, and other public goods are large and continuing (chapter 2), and so are the burdens of taxation (chapter 3). These policy differences are a necessary condition for the operation of the competitive federalism model.

We also expect to show that federal interventions reduce the responsiveness of state and local governments; federal financial aid expands state and local government services independently of any citizen demand factors (chapter 4). We expect to demonstrate that federal aid distorts the relationship between demands of consumer-taxpayers and the policies of state and local governments.

We expect to show that the responsiveness of state governments is not a product of competitive, policy-relevant party politics in the states. The "responsible party model" is rarely encountered in the states. Electing Democrats or Republicans to state office seldom results in significant policy change (chapter 5). Fortunately, however, competitive federalism operates independently of the type of political system to encourage responsiveness. Theoretically, even authoritarian governments, if they were forced to compete with each other and if citizens could migrate to the government of their choice with little cost to themselves, would be responsive to citizen preferences.

Finally, we expect to show that state and local governments make a difference in the economic well-being of their citizens. These governments affect

not only safety and amenities but income and earnings, interest and rents, contracts and jobs. The spending and revenue policies of state and local governments have economic consequences (chapters 6 and 7). It is true that these policies are felt at the margins of economic activity; many other factors affect the economic fortunes of citizens in the states. We must try to observe the effects of the policies all other things being equal. But we expect to show that "the wealth of states," like "the wealth of nations," is affected by government actions. If government policies were irrelevant to the economic well-being of citizens, then competitive federalism would offer little in the way of direct economic benefit. It might still offer protection against the political tyranny of monopoly government, but it would fail to protect against the economic inefficiency of monopoly government.

We do not pretend that competitive federalism, or any other serious model of government or politics, is value free. Competitive federalism is a normative as well as an analytical model (chapter 8). It prescribes how federalism should work, as well as describes how it would work under specified conditions. We conclude the discussion with some specific constitutional prescriptions designed to bring competitive federalism to the American system of government.

Note

1. On this point Robert L. Bish (1987) writes: "Historically the subject matter of fiscal federalism has been tax coordination and competition; more recently it has been grant programs and functional responsibilities for different layers of government. These latter analyses have been facilitated by the theory of public goods and externalities and recognition that most public goods and externalities have effects over areas smaller than the entire country. This work, however, poses interesting problems for conclusions based on market economics and federalist models because fiscal federalism studies emerge with conclusions directly contgrary to conclusions based on market economics and the political theory of federalism. And not only are conclusions of the fiscal federalism literature different, but their normative recommendations would *eliminate* the most distinguishing feature of a federal system, competition among different government."

8
Toward Competitive Federalism

> In the compound republic of America, the power surrender by the people is first divided between the 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.
>
> ——James Madison, *Federalist,* Number 51

Federalism and Competition

Creating "opposite and rival interests" within government itself was the distinctive contribution of the founders of our nation. Intergovernmental competition was structurally encouraged in the allocation of powers to the several branches of the national government and in the division of powers between the national government and the states. The focus of scholarly writings on American federalism throughout the nation's history has been on competition between the national government and the states. Competition among state governments and their local subdivisions has received less attention, yet this competition is a fundamental part of the idea of federalism.

Federalism—multiple, independent governments with significant and autonomous responsibility for the welfare of people living within their jurisdictions—offers protection for many important political values: individual liberty, pluralism, party competition, political participation, and the management of intense conflict. But it also provides an opportunity to develop the values of intergovernmental competition: (1) greater overall satisfaction of the preferences of citizens, (2) incentives for governments to become efficient and provide high-quality services at their lowest costs, (3) restraints on the size of the public sector and the tendencies of governments to oversupply goods and services, (4) greater responsiveness of state and local governments to the policy preferences of consumer-taxpayers, (5) restraints on the overall burdens of taxation and the imposition of nonproportional taxes, (6) encouragement of economic growth and individual economic well-being, and (7) encouragement of innovation and experimentation in public policy.

The Values of Federalism

The values of federalism itself have been well argued over the past two centuries, yet it is worthwhile to remind ourselves of them. First, federalism provides protection to individuals from the immense power of government. Even before the founders were in their graves, Tocqueville was warning against the dangers of centralized government to individual dignity:

> Above [the people] stands an immense and tutelary power, which takes upon itself alone to secure their gratifications and to watch over their fate. . . . After having thus successively taken each member of the community in its powerful grasp and fashioned him at will, the supreme power then extends its arm over the whole community. It covers the surface of society with a network of small complicated rules, minute and uniform, through which the most original minds and the most energetic characters cannot penetrate, to rise above the crowd. The will of man is not shattered, but softened, bent, and guided; men are seldom forced by it to act, but they are constantly restrained from acting. Such a power does not destroy, but it prevents existence; it does not tyrannize, but it compresses, enervates, extinguishes and stupefies a people, till each nation is reduced to nothing better than a flock of timid and industrial animals, of which the government is the shepherd. (Tocqueville 1835)

Federalism distributes power more widely throughout society. It encourages the development of multiple leadership groups. Pluralism among elites is believed to provide better protection for individual liberty than a single elite. The pluralist argument for federalism was expressed by political scientist Robert A. Dahl:

> States and local governments have provided a number of centers of power whose autonomy is strongly protected by Constitutional and political traditions. A governor of a state or the mayor of a large city may not be the political equal of a president (at least not often); but he is most assuredly not a subordinate. In dealing with a governor or mayor, a president rarely if ever commands; he negotiates; he may even plead. Here then is a part of the intermediate stratum of leadership that Tocqueville looked to as a barrier to tyranny. (Dahl 1967, p. 189).

Federalism facilitates party competition. State and local governments provide a political base of offices for the opposition party when it has lost national elections. In this way, state and local governments contribute to party competition by helping to tide over the losing party after electoral defeat so that it may remain strong enough to challenge incumbents at the next election. Moreover, state and local governments provide a channel of recruitment for national political leaders. National leaders can be drawn from a pool of leaders experienced in state and local politics.

Federalism stimulates political participation. Although fewer people vote in state and local elections than in national elections, more people run and win office at the state and local level. There are over eighty-three thousand governments in the United States: states, counties, townships, municipalities, towns, special districts, and school districts. Nearly a million people hold some kind of public office. The opportunity to exercise political leadership contributes to popular support of the political system. By providing more opportunities for direct citizen involvement in government, state and local governments contribute to the popular sense of political effectiveness and well-being. Public opinion studies consistently report that people believe that local government is more understandable, that they have greater confidence in it, and they feel more capable of affecting its policies.

Federalism assists in managing conflict. Federal forms of government, wherever they are found, have arisen in response to diversity and conflict within a society. Federalism allows diverse peoples, with conflicting policy preferences, to be brought together in a single nation, without placing unbearable strains on the political fabric of the national government. Potential conflicts between geographically separated interests are mitigated by allowing each interest to enact its own policies within separate states. This arrangement seeks to manage traumatic and potentially nation-shattering conflicts, to avoid destructive battles over a single national policy, to protect the integrity and the very existence of the national government.

The Values of Intergovernmental Competition

The values of intergovernmental competition have been less well understood than the values of federalism itself. Yet it is our argument that one of the great strengths of federalism is the opportunity it presents for the development of intergovernmental competition.

Let us now develop the arguments on behalf of intergovernmental competition in the light of the empirical observations of the states presented in the previous chapters.

Efficiency

Competition, information, and mobility combine to offer protection against the oversupply of public goods and services. Monopoly government is far more vulnerable to the many supply-side forces inherent in governmental and political processes. It is possible, of course, that public goods are not really oversupplied—that the growth of government is "a misplaced concern of ide-

ological conservatives." If so, we still have nothing to fear from intergovernmental competition. In our theory, competition will reduce the supply of public goods only if they are in fact oversupplied relative to citizen preferences.

The experience of state and local governments in the years since 1976 suggests that their growth can be halted. The modest yet significant contraction in the size of this sector over the last decade lends some empirical support to our argument. The growth pattern of the competitive state-local sector certainly contrasts with that of the monopoly federal sector. And it is important to note that the contraction of the state-local sector coincided with a decline in demand for the largest service function of state and local government, education. Thus, we have evidence that the state-local governmental sector contracts when demand for public service contraccts; we have no evidence to date that the federal sector can contract at all. We believe the real long-term constraint on the growth of state-local sector is competition. But we also acknowledge that some institutional features of state government—the popular initiative and constitutional prohibitions against debt—also contribute to restraint in state-local public sector growth.

The absence of good information about the true demand for public services, together with the natural tendencies of elected officials and bureaucrats to expand their functions, powers, and budgets, produces an oversupply of public goods—more than citizen-taxpayers would choose for themselves if confronted with full knowledge of their costs and benefits. But multiple governments, offering different packages of services and costs to citizens in their jurisdictions, provide information to citizens everywhere about what government services can be provided at what costs. This information is valuable to both citizens and officials because it allows them to compare governmental performances. Mobility is not absolutely essential to inspire efficiency; all that is necessary is comparative information for taxpayer-voters and competition for public office. Some public officials may welcome the challenge of comparison with other jurisdictions. Not all public officials consciously seek to obscure information in the fashion predicted by narrow models of bureaucratic behavior. Some want to do what is right but simply lack information. And voters who are informed about comparative costs—even if these voters are a very small proportion of the electorate—can influence governmental performance.

Information is an important product of intergovernmental competition, but the driving force in the competitive federalism model is mobility. Mobility, real and potential, of people, industry, and capital not only better satisfies the preferences of consumer-taxpayers but forces governments to become more efficient. There is good reason to believe that the United States is the most mobile society in the world. Approximately 40 percent of the population of the United States changes residence at least once in a five-year period; 18 percent move to a different county and 9 percent to a different state (table 8–1).

Table 8–1
Population Mobility in the United States

	Percentage of Total Population Moving over Five Years		
	1970–1975	*1975–1980*	*1980–1985*
Total movers	41.3	46.4	39.9
Different county	17.1	19.5	17.8
Different state	8.6	9.7	8.7
Different nation	1.6	1.8	1.8

Source: *Statistical Abstract of the United States, 1987*, p. 25.

Responsiveness

Governmental competition inspires policy responsiveness. Despite nationalization of the states over time in many economic and political dimensions, policy variations are not diminishing. States continue to exhibit significant differences in levels of public spending and taxation. Whatever the theoretical deficiencies of the median voter model, variation in the levels of public services provided in the states is closely associated with characteristics of the populations. For many years the determinants literature in state and local government provided good predictive models of taxing and spending based on income, education, urbanization, and other demographic characteristics of populations (Fisher 1964; Dye 1966; Hofferbert 1966a; Sharkansky and Hofferbert 1969). These early studies even identified the distortions in these relationships created by federal aid (Sachs and Harris 1964). We have shown how these cross-sectional relationships have persisted over the years. More important, we have shown that changes over time in public spending in most of the states can be attributed to identifiable changes in the demand for services, notably education. We acknowledge that bureaucracy, centralization, and institutional sclerosis are alive and well and influencing spending levels in states; many of our cross-sectional comparisons confirm the importance of these supply-side forces. But there is equally compelling evidence that the demands of consumer-taxpayers in the states also shape spending policies. In nearly all of the states, changes in state spending over time can be estimated well from a simple demand-side model, one in which school-aged population is the driving force behind the largest functional component of state-local spending, education.

Constraints

Competitive federalism places revenue constraints on policymakers. The range of variation in tax levels and burdens among the states is quite large

and has persisted over time. Tax levels are closely associated with income levels; supply-side forces have only a modest impact. However, tax burdens—state-local tax revenue as a percentage of personal income—cannot be estimated very well from income levels or other demographic characteristic of state populations. Moreover, tax burdens tend to change over time, with some states imposing heavy burdens in some years relative to other states and then dramatically lightening their tax burdens to move toward the state median. The dynamics of these relative movements resemble the convoy analogy—with some ships moving out ahead of the convoy and then falling back and other ships trailing the flotilla and then moving up into the pack.

These revenue dynamics appear to conform to a competitive pattern—one likely to be produced by competition, information, and mobility among the states. But we also speculate that the constitutional mechanisms for initiative and referendums have a very important role in tax policy. These devices facilitate closer relationships between taxpayer preferences and public policies. We emphasize their facilitative role because referendum voting does not always lead to lower taxes. Indeed, the recent record of referendum voting shows as many defeats as victories for tax limitation initiatives, and even when these measures are approved, they are not always effective in lowering tax burdens.

Competition allows citizen-voters to compare revenue burdens among the states, and this comparative information itself constrains decision making. Citizen-taxpayers have the additional option of moving or threatening to move, and knowledge of this option also constrains decision making. Moreover, special institutional arrangements in state and local government—earmarked revenues, user charges, initiative and referendum voting, balanced budget requirements—place additional constraints on state and local taxing and spending, constraints that are largely absent in the federal government. The result is general moderation in the tax burdens imposed by state and local government rough proportionality in tax incidence and tax revenues linked more directly to demands for public services.

Finally, federalism helps combat fiscal illusion. Smaller units of government prevent the costs of public services from being dispersed over so large a jurisdiction that their burdens are unnoticed. We know that interest groups seek to concentrate benefits for themselves and to disperse costs over such a wide segment of society that individual citizens have little incentive to inform themselves, organize, and devote resources to counter these special interest claims. We know that voters tend to credit their elected representatives for special interest programs that benefit them directly, yet seldom do they blame their representative for the taxes they pay for special interest programs for others. Competitive federalism helps to counter these expansionist tendencies of interest group activity by reducing the size of taxpaying constituencies and thus limiting the dispersal of costs. The costs of special interest subsidies

granted by state or local government cannot be dispersed over the entire nation in the fashion of federal government subsidies. By more closing matching costs with benefits, state and local governments are held to greater accountability by voter-taxpayers.

Distortions

The principal distortion in public policy in the states arises from the effects of the federal grant system. Consumer-taxpayers in the states cannot accurately make benefit-cost calculations because of the financial intervention of the federal government. Although the federal proportion of state-local revenue has declined slightly in the 1980s, it is still over 18 percent. Federal aid reduces the responsiveness of state-local spending to characteristics of state populations. The overall effect of such transfers is to create an oversupply of public goods; citizens and officials in the states provide higher levels of public services than they would if they had to pay their full costs from their own tax revenues. Our calculations show that federal aid has had a major stimulative effect on state-local spending. This effect appears in both cross-sectional observations (states with higher levels of federal aid spend more total and own-source money than state with lower levels of federal aid) and in time-series observations of individual states (in virtually all of the states' federal aid has been a major determinant of change in spending levels).

The expansion of the federal grant system over the years has not been driven by fiscal federalism arguments. That is, federal intervention has not come in response to concerns about "externalities"—spillover benefits and costs of state and local government activity. Rather centralization is the result of nationally organized interests' substituting their own policy preferences for those of citizens and officials in states and communities. We have explained the success of nationally organized interests by our rent-seeking theory of centralization. It is more efficient to seek subsidies, privileges, and protection at a single central location than to do so at fifty or eighty-three thousand subnational locations. Moreover, the larger national arena permits interests to disperse the costs of their specialized and concentrated benefits over a broader constituency. This reduces the burden of any single subsidy on the individual citizen and thus weakens potential opposition.

The Need for Auxiliary Precautions

Policy responsiveness in the states is clearly not a product of competitive, policy-relevant party politics. We would not have to concern ourselves so much about competition, information, and mobility if we were certain that democratic processes within the states would ensure policy responsiveness. But party competition and policy-relevant electoral politics are rarely found

in the American states. The responsible party model—competitive policy-oriented parties whose election to office brings about significant policy changes—is notably absent from state politics. It is true that differences among the states in levels of party competition and voter participation have diminished over time, primarily as a result of increased competition and participation in the southern and border states. But these changes have not been accompanied by any notable increase in policy-relevant party politics. When we observe changes in welfare and tax policies in each of the states over time, we find that these changes are largely unrelated to changes in party control of state government. The party system in most states fails to give citizen-voters a means of influencing these policy directions. The weakness of the responsible party model in the states, the absence of competitive parties, and the irrelevance of party control of state government to policy reinforce the need for auxiliary precautions for popular control of government.

Economic Development

Competition inspires the states to be concerned with the impact of their taxing and spending policies on economic growth and to become directly involved in economic development activities. Only recently has international competition begun to inspire similar concern in Washington. Prior to 1981, discussion of federal tax policy almost always centered on redistributional issues. Scholars and politicians who raised questions about the growth-retarding effects of federal tax policies were ignored or ridiculed. But developmental issues have long been central to debates over taxing and spending in state capitols and city halls, and it is competition that has kept developmental concerns in focus.

Monopoly governments have no direct way of estimating the growth-retarding effects of their tax policies. Cross-national comparisons are confounded by vast cultural differences, and longitudinal examinations of the effects of past tax policies are obscured by historical circumstances. Competing governments are in a better position to observe the economic consequences of their policy decisions. Competition provides both motives and measures for policymakers to achieve efficiency.

Over the longer term, economic growth rates in the states have been affected by the nationalization of the economy. The convergence theory helps explain why states that began at relatively low levels of economic development grew more rapidly than states that began at higher levels. It is easier for less developed states to attract the transfer of existing technology than to invest new technology. And capital and labor tend to flow to where output can rise more rapidly. But these convergence or catch-up forces may not play an important role in the future. Convergence has slowed since 1970. There is no longer enough variation among regions to permit diffusion itself to determine growth rates.

The sclerosis theory remains intriguing. Explaining growth rates by reference to the accumulated growth-retarding effects of interest group activity is intuitively satisfying. And it is true that younger states have enjoyed higher long-term economic growth rates than older states. But there has been a reversal of this pattern in the 1980s; older states have recently outperformed younger states. Specific tests of the sclerosis model have been unsatisfying. Political scientists have become confused over the difference between the relative strength of single interest groups in states (which may accelerate growth) and the aggregated influence of complex interest group systems in states (which may retard growth).

Growth-Retarding Effects of Taxes

Economic growth rates in the states are only marginally influenced by state and local government. So many other forces affect state economic development—among them changes in world demand for specific products, changes in technologies, changing energy and labor costs, discoveries of new natural resources, and developments in transportation—that it is difficult to sort out the independent effects of state tax and spending policies. Moreover, economic growth in the states occurs in spurts and lags. States that experienced the most impressive economic growth rates in the 1970s are not the same states that were growing most rapidly in the 1980s. This complicates the search for general explanations of regional economic growth.

The growth-retarding effects of heavy tax burdens and high marginal rates in the states are significant. It is true that cross-sectional observations indicate that the states with the heaviest burdens and highest rates are not always the slowest-growing states, depending on the time period examined. But the time-series evidence is somewhat stronger: raising or lowering tax burdens, especially in high-tax states, appears to retard and accelerate growth as expected.

Innovation

Competitive federalism inspires policy innovation. Perhaps the most noteworthy state policy innovations in recent years have come as a result of state efforts to improve their economic position (Osborne 1988; Fosler 1988). Just as entrepreneurs compete with new ideas in the marketplace to find an advantage over their rivals, so also public officials in states and communities have been inspired by intergovernmental competition to seek innovations in public policy.

We have distinguished between economic growth policy and state industrial policies. Economic growth policy is the provision of truly public goods and services with minimum burdens in taxes and regulations. State industrial policies generally involve special treatments—loans and subsidies, guarantees and exemptions—that in the long run contribute to economic inefficiency. But the effects of various industrial policy decisions are not easy to identify. The literature to date has failed to observe any significant aggregate growth effects for any direct state industrial development activities (ACIR 1967; Pierce, Hagstrom, and Steinbach 1979; Rasmussen, Bendick, and Ledebor 1984; Rubin and Zom 1985; Ambrosius, 1986).

There are good theoretical reasons for predicting that direct state involvement in capital formation, as well as special tax treatments, will inevitably produce inefficiencies. But competition among the states in industrial policies is self-correcting in the long run. States will gradually learn from their mistakes as they compare their progress with other states. Consider how much worse a national industrial policy would be—a monopoly government allocating capital, dispensing subsidies, and granting special privileges and protections. (Not that the federal government does not already do so in innumerable tax code provisions and subsidy programs, but a national industrial policy would legitimate and enlarge the scope of these subsidies, privileges, and protections.) The only corrective to a national industrial policy would be international competition, and far more damage would be done to the nation before global competition would exert its correcting influence. Perhaps the results of the industrial policy experiments currently being conducted in America's "laboratories of democracy" will succeed in discouraging the federal government from pursuing national industrial policy.

Competition and Public Policy

Most debates over federalism are only lightly camouflaged debates over policy. Philosophers and economists (Rawls 1971; Buchanan and Tullock 1962) may assert a distinction between constitutional issues—deciding how issues should be decided—and policy issues—deciding the issues themselves. They may argue that constitutional rules should be decided behind a veil of ignorance about the immediate policy consequences of these rules; that the decision-making process should be established before policy choices are fed into the process; that individuals should be uncertain about the policy consequences of selecting a particular constitutional process before they do so.

But in politics, constitutional decisions are never separated from policy outcomes. People do know what the policy consequences of various constitutional arrangements will be. Citizens as well as political leaders consistently

subordinate constitutional questions to immediate policy concerns. Indeed, history is replete with examples of the same political leaders arguing one notion of federalism at one time to achieve their immediate policy goal and then turning around and supporting a contradictory notion of federalism later when it fits a new policy goal. No American politician, from Thomas Jefferson onward, has ever so strongly supported a view of federalism that he or she ended up conceding a policy battle.

If competitive federalism is to be politically viable, it must be discussed in a policy context. Abstract debates about federalism or competition, devoid of policy implications, hold little interest for most citizens or politicians. "Most people have little interest in abstract debates that argue which level of government should be responsible for a given task. What most people care about is getting the policies they want" (Nice 1987, p. 24). Wise politicians are familiar with the wisdom expressed by political scientist E.E. Schattschneider years ago: "The outcome of all conflict is determined by the scope of its contagion. The number of people involved in any conflict determines what happens; every change in the number of participants, every increase or deduction in the number of participants affects the results" (Schattschneider 1942, p. 2). Thus debates about federalism must acknowledge policy consequences.

Let us consider the impact of the competitive federalism model for different types of policy decisions. Policies have been usefully classified as allocational, developmental, or redistributional (Lowi 1964). Allocational policies produce and distribute public goods and services to consumer-taxpayers. These policies encompass the provision of a broad range of state and local government services—education, health, welfare, streets and highways, police and fire protection, sewers, water and utilities, garbage disposal, parks and recreation, and so on. Developmental policies are those that directly add to the economic well-being of the state or community. These policies are directed toward economic growth; they include attracting industry, building transportation facilities, providing utilities, renewing urban areas, training the labor force for work, and so on. Redistributional policies are designed to redirect wealth to benefit particular segments of society and thus satisfy equity concerns. These policies include traditional welfare services, health care for the poor, unemployment compensation, low-income housing, as well as progressive taxation. Note that these are analytical distinctions among types of policies; any specific government activity may have allocational, developmental, and redistributive elements within it.

Allocational Policy

Competitive federalism directly strengthens the allocative functions of government. Decentralization permits governments to match services with vari-

ations in demand. Greater overall citizen satisfaction can be achieved with multiple governments' offering different packages of public services at different prices. Competition forces governors to become more efferent in its allocative activities, providing better services at lower costs. Competition forces government to be more responsive than monopoly government to citizen preferences. This has been the major thrust of our argument for competitive federalism.

The value of competition in allocative policies has not been seriously challenged. Paul E. Peterson, one of the few political scientists to incorporate the notion of competition into a coherent theory of federalism, appears to agree:

> Allocation is the function that local governments can perform more effectively than central governments, because decentralization allows for a closer match between the supply of public services and their variable demand. Citizens migrate to those communities where the allocation best matches their demand curve. (Peterson 1981, p. 77)

Developmental Policy

Competitive federalism also directly strengthens the developmental policies of government. States and communities have strong incentives to compete for capital investment, skilled labor, and advanced technology. We have argued that economic growth policies are much broader than industrial development policies. States and communities may find that special concessions to particular firms and industries are not an efficient way to increase the economic well-being of their citizens. Rather economic growth policies encompass the provision of public services—high-quality schools and universities, good highways, adequate utilities and infrastructure, police and fire protection, pleasant parks, and even effective and humane welfare services—that make states and communities attractive to managers of firms and their most productive employees. Of course, economic growth also requires that these services be purchased at the lowest possible cost. Competition increases the likelihood that state and local governments will operate efficiently, so that their taxes will remain competitive with other states and communities providing comparable levels of service.

The state's role in economic development has traditionally centered on the provision of physical infrastructure, especially transportation. Indeed for many years economic growth in the states correlated closely with state expenditures for transportation (Dye 1980a). But it is likely that economic growth in the future will depend more upon state investment in intellectual infrastructure. Economic growth is always and everywhere a function of human creativity. In practical terms, investment in education at all levels—elementary and secondary schools, trade and vocational schools, community

colleges and state universities, research institutions and parks—is likely to become the key to competitive advantage in the economy of the future. Fortunately for the future of the United States, education is largely a function of competitive state and local governments rather than monopoly centralized government. Economic competition among the states can become the driving force behind improvements in education and research.

In addition to improvements in physical and intellectual infrastructure, competition can also drive states and communities to improve the quality of life in their locales. A skilled, educated, creative work force can neither be recruited to a state nor retained if the general quality of life is considered unattractive. It is difficult to assess systematically the economic effect of public investment in parks and recreation, cultural and sports facilities, leisure activities, historical preservation, charm, and pleasant surroundings. But there are innumerable journalistic accounts of the importance of quality of life factors in industrial location decisions, particularly for newer high-tech industries. The following quotation is representative:

> Unlike smokestack industries that need access to raw materials, energy, and transportation, high-tech plants located where the quality of life is high enough to draw a skilled work force. You don't locate plants for cheap labor or even taxes. You locate where people want to live. (Osborne 1988, p. 6; see also Schemenner 1982)

It is hard to imagine a more beneficial competition among governments than competition to improve the quality of life in America's states and communities.

Thus, development policies are well served by federalism. Paul Peterson argues convincingly that the federal government would be wise to leave economic development policy to state and local governments:

> Since state and local governments are well equipped to pursue developmental objectives, most public efforts of this type should be left to them. By delegating responsibility for most developmental programs to state and local governments, the federal government would frankly admit its incapacity to use those programs to help populations with special needs. (Peterson, Rabe, and Wong 1986, p. 230)

Even strong proponents of state industrial policies warn against federal intervention. Osborne reasons that

> the American economy—indeed the world economy—is made up of a series of regional economies, each of which radiates out from a city or network of cities. Each regional economy is unique. Each has a different mix of industries, a different labor market, a different set of educational institutions, and different capital markets. In this country, the governmental unit that most

closely matches the regional economy is the state. (Osborne 1988, pp. 283–284)

Redistribution Policy

The most serious challenge to the competitive federalism model arises in redistributional policy. Can multiple competing government undertake redistributive policies without creating unbearable free-rider problems for themselves? Will states and communities be restrained from providing the welfare services they would otherwise prefer because of the threat of an inundation of poor people from less beneficent free-riding jurisdictions? Will tax burdens to support generous welfare services encourage the nonpoor—both households and business—to migrate to jurisdictions that impose lighter tax burdens because they provide frugal welfare services?

The empirical evidence to support the view that the poor will move to high welfare benefit states is very weak. Sociologist Larry H. Long in a review of the relevant literature in 1974 concluded that "no study has presented empirical evidence for the hypothesis that welfare payments themselves have attracted large numbers of persons to states and cities with high benefit levels" (Long 1979, p. 46). Long reached similar conclusions in his own research. However, Paul E. Peterson and Mark C. Rom (1987) argue that there is a significant, albeit sluggish, response of poor people to welfare benefit levels in the states. He concentrates his attention on migration patterns after 1969 when the U.S. Supreme Court ruled (in *Shapiro* v. *Thompson*) that states could not constitutionally deny welfare benefits to new residents. He calculates that increasing welfare benefits in a state increases its poverty population. He assumes that increases in the poverty population are "almost certainly due to migrations rather than welfare-induced changes in labor force participation rates" (Peterson and Rom 1987, p. 54). But the poor are not very mobile, and when they do move, they are more likely searching for job opportunities rather than higher welfare benefits.

The wealthy are more mobile than the poor. The argument that capital investment and productive labor will migrate to states with lower welfare spending rests on somewhat stronger empirical support. Underpinning this argument is the hidden assumption that individuals, families, and firms seek only to maximize their after-tax personal income; that is, they place little or no value on public services, especially welfare services from which they receive no direct financial benefit. But neither our competitive federalism model nor its antecedent Tiebout model is so narrow in its assumptions. The "utility functions" of individuals, families, and firms include their physical, social, and cultural environment, as well as their after-tax income. Few of us want to see poverty, hunger, homelessness, ill health, or deprivation in our society, even if we do not expect to suffer these maladies ourselves. States or communities that aggravate these hardships would hardly look attractive to families or businesses seeking places to locate.

Competition encourages policy responsiveness. Welfare policies, like all other policies, are more responsive to citizen demands when undertaken by multiple competitive governments rather than monopoly government. The effect of competition is neither to lower nor to raise welfare spending but to bring it into line with citizen demands. Competitive governments must seek to match their welfare policies with both the compassion and the prudence of their citizens.

Welfare policies rest primarily on the equity preferences of middle-class Americans rather than the poor themselves. We have observed that welfare spending in the states is not associated with proportions of poor, aged, or minority persons in their populations. Welfare policies reflect the economic prosperity of the states. We have already demonstrated that variations in welfare spending among the states are largely a function of income: welfare spending is higher in high-income states than low-income states, and welfare spending goes up with increases in income. The best hope for the poor lies in economic development—not only more job opportunities but also raised welfare spending.

In short, while we acknowledge that competitive federalism raises some theoretical concerns about redistributional policy, we remain convinced that the equity preferences of society are better served by multiple competing governments than centralized monopoly government. Welfare policies depend more on the equity preferences of middle-class voters than on the voting power of the poor. Welfare spending correlates with wealth not poverty. It is the wealthy who are mobile, not the poor. Whatever adverse effects competition may have on welfare policies, these effects are more than compensated for by the opportunities provided for policy diversity, responsiveness, and comparative experimentation.

Conditions for Competitive Federalism

Competitive federalism is more a theoretical model than a description of the American federal system. The model depends on a series of assumptions that are not fully realized in the real world of government. Just as various "market failures"—externalities, monopolies, immobilities, and imperfect information—reduce the efficiency of the competitive market model, so also do various imperfections limit the utility of the competitive federalism model. To summarize, competitive federalism depends on the following assumptions:

1. Autonomous state and local governments with significant independent responsibility for the welfare of the people living in their jurisdictions;

governments that offer a wide range of public policies and vary the level of public goods and services.

2. Costs of government goods and services that are equal to the revenues collected from taxpayers in each jurisdiction.
3. Limited externalities, or spillovers, of either costs or benefits among jurisdictions and no collusion among state and local governments to restrain competition.
4. The availability of good information to consumer-taxpayers about the services and costs offered by state and local governments throughout the nation.
5. Mobility of consumer-taxpayers and a propensity to consider governmental services and costs as important criteria in locational decisions.

The failure of the American federal system to realize these assumptions fully does not destroy the model. Reality is seldom perfectly consistent with models. The relaxation of these assumptions leads to various inefficiencies (see Pestieau 1984). But the model remains important for analytical purposes to the extent that it describes behavior under specified conditions, and it is important for normative purposes to the extent that it identifies conditions to be changed to bring about desired results.

The competitive federalism model, like all economic models, depends on marginal choices. Marginal choices always involve net additions or subtractions from the current state of affairs. Analytic models that depend on marginal choices are always certeris paribus; they describe and predict behavior when all else is equal. State and local decision makers, as well as consumer-taxpayers, always confront decisions involving changes given the current state of affairs. The model does not depend on the behavior of every family and firm or even most families and firms. Just as prices are set by a small group of active bidders, the policies of state and local governments can be shaped by a very small proportion of families, businesses, and inventors who are making locational decisions at the margin. All that is required is that a significant portion of consumer-taxpayers meet the specifications of the model.

The competitive federalism model is useful in directing attention to the real-world conditions that obstruct its function. If we view the model as normative as well as analytical, then we are provided with a guide to action—to recommendations for constitutional and policy changes that will shape real-world conditions to fit the model better and reap its benefits.

Constitutional and Policy Implications

Competitive federalism, viewed as a normative model, generates some clear constitutional and policy prescriptions:

1. State and local governments must be constitutionally encouraged and protected in the exercise of significant and autonomous responsibilities for the welfare of their citizens.
2. State and local governments must be free to compete against one another in the kinds of public goods they provide, in the kinds of regulations of private activity they enact, and in the nature and burden of the taxes they impose.
3. National government interventions in the domestic policy responsibilities of state and local governments must be constitutionally limited.
4. The national government must seek legislatively to reduce fiscal interventions that relieve state and local governments of the responsibility to tax their citizens fully for public services provided.
5. Families and firms must be constitutionally unhampered and legislatively encouraged to move about the country with a minimum of relocational costs.
6. The national government and the states must endeavor to provide comparative information on the quantity, quality, and costs of public services offered by the states.

Strengthening Federalism

Certainly competitive federalism requires at a minimum a constitutionally recognized federal system of government. And a federal system must mean something more than "procedural safeguards . . . inherent in the workings of the National Governments itself" (majority opinion in *Garcia* v. *San Antonio Metropolitan Transit Authority*). Rather, federalism must mean constitutionally recognized separate and autonomous national and state governments, both with significant and independent responsibility for the health, safety, and welfare of their citizens, protected by a constitution that neither can change without the consent of the other.

Recent proposals to restore federalism have sought to do so not by trying to restore the notion of a national government of enumerated powers but rather by constitutionally recognizing substantive state powers and expressly prohibiting the Congress from interfering with these powers. The ACIR en-

dorsed a series of constitutional amendments designed to instruct the courts to determine constitutional limits to congressional power over the states, give substantive meaning to state powers under the Tenth Amendment, prohibit congressional mandating of state actions, prohibit general congressional preemptions of state powers, especially with regard to interstate commerce, and restrict congressional conducting of grant monies (table 8–2). The ACIR also recommended consideration of a constitutional amendment giving two-thirds of the states the power to declare null and void an act of Congress. The White House Working Group on Federalism produced a series of legislative rules proposals that generally sought to accomplish these same goals without resort to constitutional amendments (table 8–2).

There are many eminently sensible recommendations for reforming the federal grant-in-aid system. There are hardly any commentators on the federal grant system, whatever their political persuasion, who do not call for some simplification of that system. Illustrative of these recommendations are the principles set forth for grant reform by the former chairman of the Council of Economic Advisers, Murray Weidenbaum (table 8–2).

But we must recognize that the political landscape is littered with proposals to strengthen federalism. Whatever the merits of these proposals, it is difficult to develop much political support for restraining national power. Abstract theories of federalism are largely irrelevant to the general public. Most national surveys reveal general support for the notion of federalism, generally favorable evaluations of state and local government, and general concern about the concentration of power at the federal level (table 8–3). But paradoxically many Americans want the federal government to assume even greater responsibility in specific policy areas, including some traditionally thought to be state or local government responsibilities. For example, majorities favor having a national policy for registration and voting, setting penalties for murder, establishing factory safety standards, and setting minimum wages.

Moreover, it is not likely that presidents, or Congress members, or candidates for these national offices will ever be moved to restrain national power. People expect federal officials to "do something" about every virtually every problem that confronts individuals, families, communities, or the nation. Politicians gain very little by telling their constituents that a particular malady is not a federal problem.

Thus, the restoration of federalism, if it is to come at all, will depend upon what state and local government officials do to make it happen. The future of federalism depends not on restraining national power but rather reinvigorating state and local government.

In recent years the states have experienced a healthy resurgence. They have reformed their own constitutional structures, granted greater independence to their local governments, and performed especially well in educational policy (see Bowman and Kearney 1986). It has even been argued that the state are recruiting better politicians (Sabato 1983). But the real question is how to encourage this resurgence and continue to strengthen the states. The answer is through competition.

Strengthening Competition

Federalism should mean competition, not merely decentralization. The national government itself should undertake to strengthen competition among the states. It can do so in prosaic yet effective fashion by acting to improve information and mobility. Economist Charles Tiebout described the policy implications of his original "pure theory" of local expenditures: "Policies that promote residential mobility and increase knowledge of the consumer-voter will improve the allocation of government expenditures in the same sense that mobility among jobs and knowledge relevant to the location of industry and labor improve the allocation of private resources" (Tiebout 1956, p. 423).

The federal government's role in collecting and disseminating information on the performance of state and local government is seldom recognized for its real value. Information leads to comparison, and comparison leads to pressure for better performance. Informed comparisons can assist in sharpening political processes: voters can compare the costs they pay and the benefits they receive with the treatment of voters in other states. If the comparisons are unsatisfactory, public officials have some explaining to do when they run for reelection. Informed comparisons can also assist individuals, families, and firms in locational decisions. The threat of losing investment, jobs, and productive citizens can motivate public officials to improve governmental performance. In other words, information facilitates both voice and exit options of citizens.

The federal government's role in facilitating mobility is seldom explored. The nation's founders seem to have been more interested than contemporary statesmen in ensuring interstate mobility. They explicitly provided for a common market throughout the new republic (Article III, section 10: "No state shall . . . lay any Imposts or Duties on Imports or Exports "), thus constitutionally ensuring the mobility of market goods. They also acted in a way that protected the flow of capital by preventing the states from "impairing the obligation of contracts" (Article II, section 10) or devaluing the currency ("No state shall . . . make anything but gold and silver Coin a Tender in Payment of Debts," Article II, section 10). The founders were interested in constitutionally protecting citizen mobility. They declared in the original document that "the citizens in each state shall be entitled to all privileges and immunities of citizens in several states" (Article IV, section 2) and that "Full Faith and Credit shall be given in each State to the public Acts, Records and judicial Proceedings of every other States." While the U.S. Supreme Court has

Table 8–2
Proposals to Restore Federalism

Legislative Actions	*Constitutional Amendments (Additions to Tenth Amendment)*	*Grants-in-Aid Reforms*
. Urge Congress to require statement of onstitutional authority and federaliam assessment for ll federal legislation.	1. The judicial power of the United States shall be used to decide questions of jurisdiction that may arise between the United States and the respective states, as defined by this Constitution.	1. Substitute, to the maximum extent possible, the states for the federal government in dealing with local governments.
. Seek limitations on deral regulation of the ates that interferes with ate sovereignty.	2. Congress shall make no law abridging the freedom of the people of the several states to govern their own affairs, provide for a constitution and laws, raise revenue, secure public employees, regulate commerce within the state, or exercise all other powers necessary and proper to promote the general welfare. Nothing in this article shall be construed to restrict the power of the Congress to enforce the provisions of this Constitution.	2. Substitute state and local governments for the federal government in dealing with private institutions and individual citizens.
Seek congressional strictions on the use of ants to regulate the states directly.	3. Congress shall make no law, nor shall the courts make any ruling, requiring any state to take any action that is not otherwise required expressly and explicitly by this Constitution. This section shall not be construed to limit the power of Congress or the courts to prohibit any specific action by any state that violates the Constitution or the laws of the United States.	3. Cap open-ended federal grant-in-aid matching programs (to limit federal dollar contributions to subgovernment grant recipients).
Discourage federal ants that authorize local penditures that are not thorized by the states.	4. Congress shall make no law, nor shall the courts make any ruling, pursuant to Article 1, Section 8, Paragraph 3 of the Constitution, restricting the power of any state unless such law is expressly and explicitly for the purpose of regulating the free flow of commerce among the several states or with foreign nations, or preserving or strengthening national markets of exchange.	4. Combine and move to the states (and localities) categorical federal grand-in-aid programs through a block grant process.
Seek establishment of leraliam subcommittees the judiciary committees d revision of rliamentary rules.	5. Congress shall make no law, nor shall the courts make any ruling, pursuant to Article 1, Section 8, Paragraph 18 of the Constitution restricting the power of any state unless in the absence of such law it would be impossible to carry into execution the powers delegated to the Government of the United States by this Constitution.	5. Provide maximum state discretion and minimum federal constraints in all block grants.

Table 8–2 continued

Legislative Actions	*Constitutional Amendments (Additions to Tenth Amendment)*	*Grants-in-Aid Reforms*
6. Promote optional state consolidation of federal programs.	6. No law enacted pursuant to Paragraph 3, Article 6, of this Constitution shall be construed to restrict the powers of any state unless such restriction has been expressly and explicitly stated in such law or unless in the absence of such a construction it would be impossible to carry such law into execution.	6. Place planning, audit, and review functions at the state level for grants programs, utilizing regular state agencies wherever possible.
7. Seek a requirement that Congress's intent to preempt be explicit.	7. (a) Congress shall make no laws, nor shall the Courts make any ruling, placing conditions or restrictions on the expenditure of funds by any state or legal subdivision thereof on the basis of the source of such funds, unless such funds are paid directly by the United States into the treasury of such state or legal subdivision pursuant to a contractual agreement between the United States and such state, or in the case of a legal subdivision such state and legal subdivision. (b) Conditions and restrictions placed upon the expenditure of funds of any state or legal subdivision thereof enacted pursuant to subsection (a) shall apply only to those funds paid under a program authorized in law enacted after the date of enactment of such conditions and restrictions.	7. Move regulatory authority from the federal to the state level of government where such shifts are appropriate.
8. Seek a prohibition on agency preemption by rulemaking or a requirement that congressional authorization of agency preemption be explicit.		8. Remove, where possible, spending mandates on state and local governments from federally financed programs.
9. Reform federal court jurisdiction to limit diversity of citizenship jurisdiction.		9. Give serious examination to replacing federal funding with a movement of revenue sources from the federal government to state and local governments.

Sources: For column 1, White House Working Group (1986); for column 2, ACIR (1986); for column 3, Weidenbaum (1982).

Table 8–3
Public Opinion and Federalism

Trust and confidence: "In which of the following people in government do you have the most trust and confidence?"
Federal government, 19
State government, 22
Local government, 37

Power: "Overall do you feel that the federal government has too much power, the right amount of power, or too little power over the activities of state and local government today?"
Too much power, 46
The right amount of power, 37
Too little power, 7

Efficiency: "From which level of government do you feel you get the most for your money—federal, state or local?"
Federal, 28
State, 22
Local, 29

Waste: "Which government do you feel wastes the most of your tax money—federal, state or local?"
Federal, 66
State, 14
Local, 8

Fairness: "Which do you think is the worst tax—that is, the least fair?"
Federal income tax, 30
State income tax, 12
State sales tax, 21
Local property tax, 24

"Should there be one national policy set by the federal government or should the 50 states make their own rules . . .

	Federal	*States*
. . . in controlling pollution	49	46
. . . in setting penalties for murder	62	34
. . . on the issue of registration and voting	64	31
. . . in selecting textbooks for public schools	35	61
. . . in establishing safety standards for factories	65	31
. . . in setting highway speed limits"	42	56

Sources: The first five questions are from ACIR (1967). The last question is from *New York Times*, May 26, 1987, p. 10

Note: All figures in percentages of U.S. public in national opinion surveys. "No opinions" and "don't know" not shown.

not given these provisions the scope and force of other sections of the Constitution, it has, by and large, protected interstate mobility. It has struck down state laws requiring a year of residence for eligibility to vote (*Dunn* v. *Blumstein*, 1972), eligibility for welfare (*Shapiro* v. *Thompson*, 1969), and eligibility for public medical care (*Memorial Hospital* v. *Maricopa County*, 1974).

Clearly Congress has a constitutional mandate to protect and encourage mobility. States and communities ought not to be permitted to place obstacles

in the way of citizens or firms wishing to leave their jurisdictions. State laws restricting plant closing should be closely scrutinized. Fair notice laws ought not to become legal devices for obstructing mobility. (Nor should federal courts permit states or cities to claim that a business franchise, such as the Baltimore Colts football team, is public domain.) If firms contractually obligate themselves to remain in a particular jurisdiction, then that is their own burden, and the market will eventually reward or penalize them for their decision. But state and local governments must not be permitted by law to interfere with the mobility of capital.

Congress should also consider legislative approaches to facilitate the mobility of labor. It might begin by reviewing unemployment compensation, welfare, and food stamp programs to determine what immobilities have been induced by these programs and how these immobilities might be corrected. Congress might review the Federal Employment Service Program to encourage interstate transfer of information to job seekers. Greater mobility might be sought through the federally funded Job Training and Partnership Act program. In general labor ought to be encouraged, rather than discouraged, to move about the country in search of the most productive, highest-paying employment.

American Values and Competitive Federalism

American federalism cannot be sustained without underlying support for the values of individualism, competition, and opportunity. The linkages between these cultural values and federalism are not always explicit. Yet the survival of federalism depends not so much on efficiency arguments as it does on the values it embodies for the American people.

Markets are decentralized, voluntary, and competitive. To the extent that federalism creates a quasi-market in public goods and services, it embodies these same values. In contrast, centralization entails coercion and uniformity. Efficiency, if it is achieved at all, comes about through coercion—central authorities that can "audit, investigate, threaten, encourage and most important cultivate professional support [among bureaucrats] to bring about the desired level of compliance." The competitive features of federalism are more consonant with the underlying values of the American people than the coercive features of centralized government.

Mobility too is highly valued in American culture. It is not only vertical social mobility that is so highly valued by Americans but also movement about the country. Mobility is an individual response to unhappiness with conditions in a particular place. It does not require the organizational or political resources necessary to effect change within a community or society. The individual can act independently, packing up the family and going else-

where. Indeed, escape from oppressive economic or political circumstances has played a unique role in the formation of the United States. The nation was populated by people who acted individually or in families to leave behind them seemingly intractable economic or political problems of their homelands. Movement provided Americans with a paradigm for problem solving, relocation, rather than submission or revolution.

American ambivalence toward equality may be the most vulnerable aspect of federalism. Different meanings attached to equality shape attitudes toward federalism just as they shape many other political attitudes. People are ambivalent about what kind of equality they want: equality of opportunity (to make of oneself what one can to develop one's talents and abilities and to be awarded for one's efforts and achievements) or equality of results (with everyone sharing in the economic well-being of the nation and no great disparities in income or life-style).

Clearly federalism is at odds with the idea of equality of results. Independence, diversity, and competition all mean inequality. In contrast, centralization and uniformity are better suited to achieve equal results. Virtually every recommendation for federal intervention in any policy issue is accompanied by an appeal to equality of results standards. These appeals are frequently successful because Americans do apply equality of results standards to the public, political spheres of life. In the private economic spheres of life, they are more likely to invoke equality of opportunity, but not when it comes to public goods and services. The idea that governments might provide individuals with different levels and types of public services in different locations throughout the nation is not as easily accepted as the idea that markets provide individuals with different amounts and types of goods.

The importance of attitudes toward equality to federalism was well stated by political scientist Aaron Wildavsky in an essay appropriately entitled "Federalism Means Inequality":

> Uniformity is antithetical to federalism. The existence of states free to disagree with one another and with the central government inevitably leads to differentiation. Yet states must differ if they are to do more than obey central directives. Were there to be a change in values toward equality of condition, the political culture that undergirds federalism would fall apart. You can have a belief in equality of opportunity to be different, but you cannot have a belief in equality of results to be the same and still have a federal system. (Wildavsky 1985 p.7)

In short, the struggle over federalism is linked to important value conflict in American society. Federalism is more than an argument between national elites and their state and local counterparts over who should govern. It is more than a strategic positioning of interest groups seeking more easily to

concentrate benefits for themselves and more widely disperse costs to others. And it is more than disguised policy conflicts with participants seeking the most favorable decisional arena. It is all of these, but it is also an expression of contrasting social values: hierarchy, collectivism, redistribution, and equality of results versus individualism, competition, efficiency, and equality of opportunity. The erosion of federalism over the past half-century reflects the nation's changing values—its greater concern for redistribution and equality of results. The preservation of federalism depends on a resurgence of national interest in economic development and equality of opportunity.

Appendix: Studying Public Policy In the American States

The American states provide an excellent opportunity to develop and test propositions about political economy. Indeed, from the perspective of systematic scholarship, federalism is a great asset. It allows variations in public policy that permit us to develop and test propositions about their causes and consequences. States can truly be laboratories in helping us to understand why governments do what they do and what differences they make in our lives.

Public policies—the activities of government—can be viewed as dependent or independent variables in research design, depending upon whether one is interested in learning about their causes or consequences. Public policies are viewed as dependent variables when we are trying to determine why states do what they do—that is, when we are trying to explain these policies. Public policies are viewed as independent variables when we are trying to assess their effects on economic conditions in the states—that is, when we are trying to explain economic development in the states.

Throughout this book, we explored a variety of theories that offered explanations of public policy and economic growth. We developed and tested models derived from these theories—models that included propositions about relationships among popular preferences, government policies, and economic outcomes.

Models are simplified representations of reality. Model building is an art as well as a craft. We build models to simplify and order our thinking so that we can better understand the complexities of the real world. A model must not be so simple or abstract that it fails to reflect reality, yet it must not be so complex and complicated that it fails to clarify our thinking. It must be congruent with reality and have real-world empirical referents. It must be creditable not only in terms of its own internal logic but also in terms of the real-world relationships it mimics. Models must be insightful; they must identify truly significant relationships in the real world and screen out the irrelevant. But what is "significant" or "irrelevant" is a function of our purposes and values.

Models reflect the purposes of the model builder. The models developed in this book focused on the causes and consequences of the activities of state and local governments. Our purposes were to assess the responsiveness of these governments to the preferences of their citizen-taxpayers and to estimate the effect of their policies on the economic well-being of their states.

The models we used were very simple. We opted for simplicity and clarity, perhaps at the sacrifice of more complete explanations. Our object was usually to test the explanatory power of a model, not to predict values of the dependent variable. Often explained variance (total R^2) was quite low. Of course, the ideal would be to develop simple models with great explanatory power. But our primary purpose was to test simple explanatory models, not to increase explained variance.

Simplicity is a virtue. We tried to avoid atheoretical impulses to throw large numbers of variables into giant regression cauldrons. Our explanations are seldom independent of each other and cannot be treated as additive. Most measures are only crude surrogates for the concepts they represent. We expected large error terms. But we wanted to observe simple associations to help inform our theories.

We employed several research strategies throughout this book in testing propositions about the cause and consequences of state policies. Each of these strategies answers separate types of questions:

Cross-sectional analyses: Cross-sectional analyses compare conditions across the states at particular period in time. Traditional studies of the "determinants" of public policy in the American states (Dye 1966; Sachs and Harris 1964; Fisher 1964) compared public policies, usually expressed as taxing and spending levels, in all fifty states at various periods in time. Cross-sectional studies ask such questions as: Why are the policies of some states different from those of other states? Are differences among the states in public policy associated with differences in conditions hypothesized to explain these policies?

Consecutive cross-sectional analyses: Examining relationships between public policies in the states and conditions hypothesized to explain these policies at different points in time permits us to ask additional questions: Do the conditions that appear to explain policy differences at one time succeed in doing so at other times as well? Are the policies associated with economic well-being at one time also associated with economic well-being at other times? In other words, do our explanations of political efficiency hold up over time? Are our explanatory models weakening or strengthening over time?

Time-series analyses: Neither cross-sectional nor consecutive cross-sectional analyses deals with dynamic processes. These modes of analyses are essentially static in nature, analogous to snapshots at particular moments. In contrast, time-series analyses allow us to examine relationships between changes in public policies over time and changes in political, economic, or demographic variables. We can ask: Are changes in public policies responsive to changes in economic conditions? Does economic activity increase or decrease in response to changes in taxing or spending policies?

Separate state time-series analyses: By undertaking fifty separate time-series analyses—testing the explanatory models on each of the fifty states—we can ask whether the models apply to all of the states or only to some of them. If it turns out that a model explains conditions in some states and not others, we can ask what distinguishes the states in which the model works from those in which it does not. By undertaking fifty separate time-series analyses rather than pooling all observations at all periods of time, we are able to specify the states in which the models are successful.

Pooled analysis: Because of the small number of observations (N) available on the American states over the time span studied (a maximum of fifty in cross-sectional analyses and thirty-five in time-series analyses), we are limited in the number of independent variables we can use in any regression problem. In certain instances, however, we have undertaken to pool observations from all states at all times in order to expand the N and thereby permit the introduction of multiple control variables. Unfortunately, the trade-off for this expanded N is an inability to specify which states or which time periods are conforming to the hypotheses. But the pooled technique is useful in resolving some problems of interdependencies among independent variables. It allows us to ask such questions as the following: Overall, among all states and all time periods, what generalized effects do tax burdens have on economic growth? Do tax burdens have any general effects on economic growth independent of other forces affecting state economies?

Clarity of understanding is preferred over methodological elegance throughout this book. Methodology is an aid in explanation, not an explanation itself. We believe that knowing what we are talking about in substantive terms at each step in the analyses is preferable to talking about statistical artifacts. Thus, for example, we chose explanatory variables with real-world referents, such as per capita personal income, rather than artificially constructed factors. And we preferred simple bivariate correlations and regression analyses so that we learned what relationships existed among the variables before we proceeded to test multivariate explanatory models. Our cross-sectional regression problems were all linear least-square estimates of interval measures. Correlation coefficients (r) and standardized regression coefficients (β) were reported in the tables rather than regression coefficients (b), because in model building, we are concerned primarily with the strength of relationships rather than estimates or predictions of the dependent variables. We used an asterisk to indicate whether the F-test permits rejection of the null hypothesis at the .05 level of confidence. Our time-series regression problems employed the Cochrane-Orcutt procedure for first-order serial-correlation correction. We reported R^2s and T statistics for each problem. T statistics are simply the b values divided by their own standard deviations; T statistics of 2.0 or above permit rejection of the null hypothesis at the .05 level of confidence.

The data base for this inquiry, $TATE$, consisted of fifty separate state data sets of fiscal and economic variables, together with an aggregated national data set. Each data set included state government revenue, total and by source, and expenditures, total and by function; combined state and local government revenue, total and by source, and expenditures, total and by function; total personal income and personal income by type and industry source; and total employment and unemployment and employment by industry group. These measures were combined with a wide variety of population characteristics; indicators of economic resources and social needs; party competition, voter participation, and partisan control of state government; bureaucracy, centralization, unionization, and interest group activity; and region and climate. Observations for most fiscal and economic variables extended from 1952 to 1985 for all states (except Alaska and Hawaii which extend from 1957 to 1985). $TATE$ was constructed to facilitate cross-sectional analysis at any point in time and time-series analysis for any individual state.

The principal sources of the data for $TATE$ were the various editions of U.S. Bureau of the Census, *Governmental Finances*; U.S. Bureau of Labor Statistics, *Employment and Earnings*; U.S. Bureau of Economic Analysis, *Survey of Current Business*; and U.S. Bureau of Census, *Statistical Abstract of the United States*. Unless otherwise noted in tables or text, the source of the data presented in this book is $TATE$.

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About the Author

Thomas R. Dye is McKenzie Professor of Government and Policy Sciences at Florida State University. He received his B.S. and M.A. degrees from Pennsylvania State University and his Ph.D. degree from the University of Pennsylvania. He is the author of numerous books and articles in American government and public policy including *The Irony of Democracy* (with Harman Zeigler), *Politics in State and Communities, Understanding Public Policy, Who's Running America?, American Politics in the Media Age, Power in Society,* and *Politics, Economics, and the Public.* His books have been published abroad and translated into many languages, including Russian and Chinese. He has served as president of the Southern Political Science Association, president of the Policy Studies Organization, and secretary of the American Political Science Association. He is a member of Phi Beta Kappa, Omicron Delta Kappa, and Phi Kappa Phi, and listed in most major biographical directories including *Who's Who in America.*