

THE NEW FEDERALISM

Restraining Leviathan

*If free trade is federalism's heir,
protectionism is the best way to ensure
a future for Big Government.*

JOHN O. MCGINNIS

TODAY trade among nations in goods, services, and financial instruments is conducted more freely, openly, and abundantly than at any time in human history. An economic boom of unprecedented scope is also sweeping the globe. These two trends are directly related and in deeper ways than conventionally thought. The usual explanation linking free trade to prosperity is that free trade creates wealth by allowing each nation to specialize in what it produces most efficiently.

The economic argument for free trade—the theory of comparative advantage—is certainly a part of the explanation of global economic growth, but it is radically incomplete.

The more fundamental argument for free trade is political: it restrains government's ability to redistribute wealth and hamper enterprise. Since the beginning of recorded history rulers of all kinds have used taxation and regulation to extract wealth from their citizens, thereby discouraging productive economic activity. The story is essentially no different in contemporary democratic society in which the rulers are the people themselves: the elected ruling coalition may tax and regulate for the benefit of its members with the same harmful effect on productive activity.

Global opportunities for trade and investment, however, inhibit government's natural tendency toward the expropriation of wealth. If individuals may choose where to invest and companies may choose where to produce, they gain leverage against Leviathan. The ability to make an economic exit generates an internal political dynamic by which the government is compelled to behave rationally toward the more productive forces in society. It therefore constrains the power of politicians to construct new col-

lectivist social reforms on the order of the New Deal or the Great Society.

The political order that free trade and global financial markets are creating is therefore one of the most important developments of our time. The new regime of global free trade has been generated by two powerful trends arising in the post-World War II West. First, a series of international trade agreements, such as the recent Uruguay round of the General Agreement on Tariffs and Trade, and regional pacts, such as the North American Free Trade Agreement, has lowered tariffs and other barriers that previously hindered free trade. Second, as governments have put fewer restraints on the exchange of their currency and financial instruments, world financial markets have become more open. According to former Secretary of State George Schultz, the international financial markets have become the "courts of allocations of world saving," assessing daily the soundness of the economic policies of every major industrialized nation.

This new regime of free trade and global financial markets is beginning to become a central issue in American politics. It is hardly startling that left-wing Democrats like Minority Whip David Bonior are shrill in their opposition: they necessarily reject any constraint on government's ability to redistribute wealth to interest groups that will keep them in government. More surprising is the dissipation of the Republican party's post-war consensus in favor of free trade and global markets. Patrick Buchanan has made an attack on free trade the fundamental economic argument of his campaign, and has warned against the dangers of international economic bodies such as the World Trade Organization. If the global free-trade regime is to remain a cornerstone of Republican and conservative policy in the next century, Mr. Buchanan's arguments must be answered.



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Buchanan is fundamentally mistaken in his view that free trade is a force antithetical to traditional American conservatism. In fact, the political regime of free trade today largely replicates the effects of federalism—the keystone of the constitutional design of the original American republic. In the original constitution, the essential economic function of the national government was to sustain a free-trade zone to dismantle customs duties and other barriers that would frustrate the exchange of goods and services among former colonies. The Constitution, however, confined the national government's domestic

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power largely to trade matters, thus leaving the rest of economic and domestic regulation to the states. Although the states were thus repositories of enormous and potentially tyrannical powers, the free movement of goods and people among them restrained their ability to use their power to extract wealth from their citizens.

Indeed, economists today have explained that the original constitutional design of a federalist free trading system was at the heart of the steady growth of the United States into an economic superpower by the beginning of the twentieth century. But federalism was more than just a political engine of economic expansion. It was perhaps the Framers' most important contribution to solving the greatest dilemma of political theory. As Stanford political scientist Barry Weingast has recently reminded us, a government needs to be powerful enough to protect property rights, but a government sufficiently powerful to accomplish this end is also powerful enough to expropriate the wealth of its citizens. Friedrich von Hayek saw that federalism provides a structural solution to this dilemma. Forcing state governments to compete for the capital and skills of a national citizenry imposes substantial limits on a state government's ability to expropriate. The emerging free-trade regime performs the same essential function today.

In fact, the free-trade regime is an important impetus behind the regulatory relief and dismantling of government agencies that the Republican Congress is beginning to enact. Over the last decades the free-trade regime has silently strengthened anti-regulatory interest groups because businesses in the global marketplace are acutely aware of regulations that disadvantage them and thus threaten to exit if they do not receive relief. Without the continuing pressure of free trade and global financial markets, however, interest groups who benefitted from the previous regulations will scurry to Congress at the first favorable turn of political events, and a new infestation of burdensome regulations will erupt.

The beneficial effects of this new political regime, however, are not limited to the economic sphere. The international trade regime also tends to limit the baleful social experiments that many Western nations have tried in this

century. Mr. Buchanan rightly deplors America's cultural decline and the resulting social disorder and deviance. He correctly diagnoses much of this decline as rooted in the federal welfare programs of the last decades with their relentless assault on the traditional American value of self-reliance. Surprisingly, however, Mr. Buchanan fails to understand that the free-trade regime currently is the best hope for containing the follies of social engineering. The federal government is less capable of redistributing wealth and power to bureaucrats, teachers' unions and the "helping professions"—the iron triangle of the modern welfare state—if the burdens these groups impose on American business rapidly harm our position in the global economy. The Federal Government is also less capable of hiding the costs of programs by passing them onto future generations if the international capital market immediately operates to punish the government for deficit spending by forcing up interest rates.

Anyone who doubts the importance of the free-trade regime in restraining the forces that have eroded American exceptionalism should consult American history. In the nineteenth century, when the states rather than the Federal Government were responsible for general economic and social regulation, the states did not undertake social experiments because they were in competition with one another. In the 1930s the Roosevelt Supreme Court destroyed the constitutional limitations that prevented the Federal Government from directly regulating manufacturing and the conditions of labor, thereby weakening regulatory competition among the states. Only after the dissolution of free trading federalism did the era of reckless social reform begin. Then, as the regime of international trade and global financial markets created more regulatory competition among nations, the new social initiatives of the kind generated by the New Deal and the Great Society became less frequent.

WHAT is valuable about Mr. Buchanan's complaints—his warning that international economic organizations are a potential threat to our liberty—can also be underscored by analogy to American history. Just as the New Deal weakened regulatory competition among the states, so could global regulatory competition be eviscerated by vesting vast new regulatory powers in the international or regional bodies.

The problem with Mr. Buchanan's warning is not that it is completely wrongheaded, but that it is premature. The new World Trade Organization, for example, has only the modest powers necessary to preserve open markets. It has the authority to permit members of GATT to impose sanctions on nations that violate their GATT obligations by discriminating against the products of another nation. It does not, however, possess anything approaching the authority to make general economic and social policy for nations. Nor does it possess the authority to displace the domestic law of nations by operation of its judgments: the United States must affirmatively decide to change any laws found to be in violation of GATT. Indeed, at the level of international trade the current danger is not that world trade institutions will usurp domestic

powers, but that they will collapse because of domestic protectionist pressures that Mr. Buchanan and some others are trying to intensify.

There is also reason to hope that international economic entities may have difficulty gaining unwarranted regulatory powers. Nationalist sentiments in favor of sovereignty and against foreign influence are a very powerful barrier against such a transformation. Individuals now identify with their nations at least as much as individuals did with their states at the time of the framing of the Constitution and it took more than one hundred years for American federalism to disappear. Nevertheless, the bureaucratic imperative is to expand

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powers and it would thus be a great mistake to become complacent about the long-term potential for mischief of any international economic organization. Given its worldwide jurisdiction, an international entity with direct power over internal social and economic regulations of nations could undertake initiatives that might make the New Deal and Great Society eras look like exercises in prudent political stewardship.

Indeed, already interest groups are sensing the potential of world economic organizations to develop into instruments of redistribution which can be turned to their benefit. In particular, labor and environmental organizations have attempted to use world trade agreements to establish structural mechanisms capable of imposing regulations on their behalf. These interest groups forced the Clinton Administration to renegotiate the North American Free Trade Agreement and include new side agreements requiring Mexico to enforce specific labor and environmental standards, thus inhibiting regulatory competition.

In other parts of the world we are witnessing a far more radical transfer of general regulatory powers from nation states to regional entities. For instance, the newly created "social chapter" of the European Union now permits a commission in Brussels substantial input into decisions of European countries about such domestic matters as the minimum wage and unemployment insurance. The British Conservative government has rejected the social chapter because the chapter's centralized policies of high regulation would lead to the high unemployment and slow growth now so notorious in continental Europe that the term "Eurosclerosis" has been invented to describe them.

The British conservative government has also resisted committing Britain to the European Monetary

Union. Many conservatives believe that such a monetary union is a dangerous step toward a single European state. Even in the absence of a single superstate, a common currency could weaken the political discipline that a free trade and investment regime brings to bear on nations, because international financial markets could no longer hold individual governments as directly accountable for poorly designed economic policies as they can today. For instance, in his recent book *The Agenda*, Bob Woodward details the extent to which Clinton's initial ideas for free spending social programs were curtailed by fear of how the international financial markets would react to the resulting deficits.

Therefore one of the most important tasks for statesmen of the right in the coming century is to prevent the global regime of free trade and investment from being strangled by international centralization. First, the Republican Congress must oppose the expansion of agreements in NAFTA that impose internal labor or environmental standards on its member countries and resist any attempt to make similar agreements part of the GATT. Second, it is not too early for Congress to be considering long-term amendments to our laws, including the Constitution if necessary, to prevent international bodies from ever having the power to issue decisions that are automatically binding as a matter of United States law. Finally, just as conservative statesmen have celebrated federalism, they must publicize the benefits of the current free-trade regime and make clear how it could be destroyed by international regulatory centralization.

Trumpeting the benefits of free trade may be the most important political imperative of all because, in the contemporary world, free trade is the best way to sustain a conservative polity. Political thinkers from vastly different eras, including Aristotle and Machiavelli, have agreed that a "mixed regime"—one in which democratic elements are counterbalanced by others—leads to greater political stability, more security for property, and greater prosperity for society as a whole. The genius of the Framers was that they translated the idea of a mixed regime into a society with no fixed classes. They tried to restrain the excesses of pure democracy by establishing structural mechanisms such as federalism and a judiciary capable of enforcing constitutional guarantees of property.

Today free trade functions as the principal restraining mechanism. In its absence, the modern democracy of centralized nation states tends to burden the most productive and talented in society, because power in unadulterated democracy resides in concentrated interest groups, regardless of their contribution to the productivity of society. In the end, burdening the productive through a process of redistribution creates social instability, since redistribution affronts the individual's natural



"You realize, of course, that these imply free will?"

sense of justice—which tells him that he should retain as much as possible of the product of his labor. Moreover, handicapping the most productive depresses economic activity and makes everyone, including the poorest, worse off in the long run.

The defense of the global free-trade regime should therefore be an issue that unites the two most important elements of the right's coalition—classical liberals (now often called libertarians) and traditional conservatives. Libertarians have straightforward reasons to embrace the regime: any governmental structure that forms a bulwark against redistribution and expropriation is a structure worth preserving. For conservatives, the argument is more complex because while they appreciate the importance of protecting property, they are legitimately concerned that the economic dynamism of free trade may create social dislocations and dissolve traditional values. Mr. Buchanan reflects these concerns when he excoriates the effects of international trade on middle-aged men and rustbelt communities.

BUT any disruptions caused by the international trade regime itself are more than counterbalanced by the disruptions the trade regime prevents government from causing. Traditional conservatives understand that the loss of property sustained by individuals is not the most important harm of redistributive policies. While most people seek to use democratic government to obtain additional resources for themselves, no one wants to see himself as a self-seeker. Citizens thus have a natural impulse to satisfy their private interests while deceiving themselves that they are serving the public good. That is the reason that in the modern welfare state left-wing politicians are most successful when they cloak their redistributive policies in the rhetoric of the public interest. The Great Society represented an enormous transfer of wealth and power to bureaucrats, academics, and certain other classes of professionals at the expense of others but it was falsely sold as a way of ending poverty. As conservatives well know, such utopian crusades result in the greatest social convulsions of all, because they disrupt the settled patterns and incentives of an organic society. If the global trade regime plays a substantial role in frustrating these schemes, it must be accounted on balance as a conservative force.

Creating a coalition of conserva-

tives and classical liberals in defense of the regime of free trade and regulatory competition is essential because the stakes are so high. When federalism was gravely weakened by the centralized nation state created by the New Deal, a new mixed regime could still be reconstituted by forcing nation states to endure regulatory competition in a free-trading world. But if new centralized global entities capable of destroying regulatory competition are created, no other set of worlds is available to establish a mixed regime through the discipline of regulatory competition. Instead big government will have gone global. International interest groups will clash with one another for a greater share of resources and that clash will be made even more bitter and destructive because the benefits will be allocated by distant international bureaucracies without ties of sentiment or tradition to individual peoples. It will be an international war of all against all, with resulting loss of stability and prosperity on a worldwide scale. □