

FEDERALISM AND INDIVIDUAL SOVEREIGNTY: COMMENT ON BUCHANAN

Jean-Luc Migué

James Buchanan has succinctly restated the Tiebout tradition of federalist analysis. The foremost contribution of federalist structures is to minimize political coercion in society and thereby to promote the advancement of human liberty. As Buchanan (1995/96: 260) puts it, “competitive federalism . . . is simply the extension . . . of the market economy to the organization of the political structure.”

Although most economists, if not most observers, would agree that the entry and exit process is the determining feature of federalist structures, I feel obligated to bring out the limits of that arrangement in contemporary national federations. The downside to the competitive process as envisioned in “idealized federalism,” writes Buchanan (*ibid.*: 265), is that “no existing political structure comes close to the ideal.” As Buchanan argues, once constitutional limits to the power of the central government break down, as occurred in all federations in the last 50 years, the benefits of intergovernmental competition also evaporate. I now wish to argue that the consequences can be worse than monopoly government.

Limits to National Federalism

In the Tiebout analytical tradition, resource mobility through decentralization offers a substitute to, not a transformation of, the political process, as the instrument to discipline governments. Economic agents can choose the administrative location in which to place their assets rather than seek to influence government directly. Individuals and firms act in their capacity as asset owners rather than as voters or

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Jean-Luc Migué is Professor of Economics at the Université du Québec. This paper is based on a presentation made at the Mont Pèlerin Society’s regional meeting in Cancun, Mexico, January 15, 1996.

political actors in their attempt to maximize value. But the voice process itself is not essentially changed. The fact is that public choice analysts assume that the working of the political process under federalism remains the same at all levels of government as in unitary regimes. The exit mechanism is merely superimposed on politics as a constraint on decentralized authorities. It can therefore be argued that there is no specific economic theory of federalist politics. Only indirectly is the analysis of federalism related to the public choice tradition. Such an argument carries analytical implications in conditions in which "constitutional guarantees against federal encroachment on the authority of states were undermined by executive, legislative, and judicial departures from established principles" (*ibid.*: 266).

The Tiebout theory of federalism is based on the assumption of firm constitutional limits on the powers of the federal government. Once the division of powers breaks down, the functions of the two levels of government overlap more and more. Taking Canadian modern history as a case in point, Ottawa, along with the provinces, is active in most fields that constitutionally are the sole jurisdiction of the provinces: namely, manpower training and apprenticeship, social services, culture, housing, tourism, and sports and recreation. For the past 40 years, the federal government has shared with the provinces in the cost and implementation of the most rapidly expanding programs, such as medicare, higher education, and welfare. And of course equalization programs, which by nature affect all provincial fields, must also be included in areas of overlap. Taken together, these fields account for the bulk of the modern expansion in public budgets. The irony of it all is that despite the overwhelming role taken on by our central government, a large current of opinion in Canada holds that Canada is the most decentralized federation in the world.¹

In fact, everywhere today national federations find themselves in a situation in which two or more levels of government compete for the same voters in the supply of similar services in a given territory. By analogy, with the extraction of oil from a common pool by two or more producers, direct competition for votes by two levels of government gives rise to a common-pool problem. If one views votes as inputs in the production of political outputs, then it is in the interest of both government suppliers to seek to gain the votes in implementing programs first. Should one of them abstain from supplying the political output, the potential gain of votes would be lost in favor of its competitor. Competition in the absence of property rights results in waste through rent-seeking. Competition between two vertically structured

¹For a recent restatement of this position, see Andrew Coyne (1995: D5).

governments leads each one to attempt to realize the net political benefits for fear of losing them to its competitor. Yet, *ex post*, the political profit is dissipated for both.

One consequence of this process is a tendency for all levels of government to oversupply and to overregulate—in fact, to coerce potentially more than monopoly governments. Here is an implication of public choice under federalism that runs counter to predictions derived from the more familiar Tiebout line of analysis. That means there are two forces operating in a typical modern federal system, a coercive-expansionist force rooted in the political dynamics analyzed here and a restrictionist force based on the mobility of resources among decentralized entities. This distinction may explain why the empirical record is rather mixed on the contribution of federalism to containing government growth.²

A New Federalist Order

Despite the limits that history has placed on the action of federalism, I suggest that optimism remains the order of the day. Contemporary movement toward freer trade in goods and factors and toward common-market arrangements throughout the world provides a unique opportunity to overcome the drawbacks of monopoly government as well as the common-pool problem of multilevel government competition. The power of national governments to coerce in traditional federations mainly originates from a central government having the power to rule over the whole national area behind trade barriers. Now it seems that protectionism is no longer a viable alternative. In the last several years, various GATT-type arrangements, common-market treaties, and other freer-trade agreements within blocs have acted to constrain the power of national governments to maintain trade barriers.

Once protectionist impediments to exit are removed, national governments find themselves in the approximate position of a province or a state or a canton vis-à-vis the national economy in a federal state. The Tiebout mechanism comes into play, not mainly as a result of a new consensus on the virtues of limited government, but because the national government loses its traditional powers to rule over society and regulate the economy. The monopoly power of unitary governments, as well as the common-pool problem of federalist politics, can be alleviated to the extent that free movement of resources allows resource owners to move away from excessive taxes and regulations.

The determining characteristic of a federalist structure is extended to the international economy to the extent that responsibilities are

entrusted to authorities that have no power to tax or regulate the whole area in which trade is free. Not surprisingly, opposition to the North American Free Trade Agreement (NAFTA) came largely from Canadian and American environmentalists and organized labor, who feared increased competition from the expansion of opportunities in Mexico. That means that in most countries of this hemisphere, certainly in countries of the European Union and of North America after NAFTA, residents can more easily escape the burden of monopoly governments or multilevel competition either by purchasing their supply outside the country or by moving their assets or their person to neighboring countries offering more favorable legislation. Asset owners voluntarily enter the association endowed with the power to rule over them.

Free Trade as the Driving Force behind Government Withdrawal

I submit that the global movement toward free trade in the Americas, in Europe, and generally throughout the world after five rounds of successful GATT negotiations, is the real force working in favor of government withdrawal. This force of freedom, more than intellectual and technological changes, more than the realization that governments do not work, more than the intellectual awareness of the virtues of limited government, seems to be the dynamic behind the modern shift to "conservatism."

That such a movement is taking place can hardly be denied. It is visible everywhere in the greater reliance placed on freer markets, on the profit motive, on the sovereignty of the consumer, in the greater responsibility of people to take care of themselves and their families, and on the right of people to keep for themselves more of the fruit of their efforts. In turn, there is less reliance on progressive and higher taxes, on extensive social programs, on public enterprises, and on bureaucratic regulation of the behavior of workers and enterprises.

Even a traditionally social democracy like Canada cannot, after NAFTA, escape the trend away from interventionism. Deficit reduction by spending restraint dominates fiscal policy debates. Our traditional docility toward rising taxes seems to have waned. The pace of privatization is still lively. Government bailout of business has lost its appeal. Public opinion seems to be solidly behind reforms of unemployment insurance and welfare.

Nationalism as a Rationale for Decentralization

Buchanan deplores the fact that Europeans, the British in particular, readily accept being coerced, provided the coercion originates from

their own national government. That suggests that one should take a more philosophical approach to the question of nationalism as a rationale for decentralization. The public choice tradition has taught us to give little weight to how people rationalize their political and constitutional position. What matters more is that real forces and incentives work in the desired direction.

Economic analysts, and all free people, for that matter, need to resign themselves to an objective fact: that the competitive virtues of federalism, which serve as the basis for their enthusiastic support for this structure of government, are not a popular vision. Whether in Europe or in national federations, people can hardly conceive of their elected national government as not striving for the common good. How can a candidate to elective office elicit enthusiastic support for his or her candidacy to a necessary but failed, if not evil, institution? Just recently, in my own province of Quebec, half the population was ready to jump into the catastrophic unknown of secession as a result of their faith in their provincial government. Not once in the referendum campaign were the competitive dimensions of federalism even mentioned by the defenders of the federalist structure. The partisans of secession, as good social democrats do everywhere, even made their case for separation as a shield against the “right wing” forces now invading the rest of America and threatening the Canadian social programs. Even in the recent confrontation over the budget between the Congress and the President, the virtues of competitive rivalries between component governments were seldom invoked. Rather, the movement was based on the belief that states can do a better job because they are closer to the people.

Although intellectually disappointing, the appeal of devolution to nationalist forces need not depress federalists. There is an upside to that state of affairs. In common markets and free trade areas, people’s faith in their own national government can serve as a protection against the risk of repeating the history of overcentralized national federations. That is clearly relevant to the European Union. Even in North America, the incorporation into NAFTA of side deals on the environment and labor has shown that we are not immune to the risk of a shift of power to the supranational level. In the campaign to overcome the powerful centralist forces at work everywhere, federalists need all the friends that they can find.

Constitutional Safeguards Less Urgent

In a more optimistic perspective than suggested by Buchanan, I would even submit that in a world where the federalist process is

forced upon us by outside conditions, namely free trade, the task of setting constitutional safeguards by political action loses some of its urgency. The international federalist competitive model comes into play without it being necessary to limit, legally or constitutionally, the legislative power of the various national governments, provided the mobility of resources is not hampered. In a decentralized system, such as occurs after free trade, exit, not voice, is the paramount instrument at the disposal of individuals to discipline their government and make their preferences known.

Centralization, Community Bonding, and National Survival

Finally, in support of Buchanan's opinion that "community bonding" is an active value in society that can preferentially flourish in a federal system, I would like again to offer the example of recent events in Canada. In Canada, the shift of transfer activities to the central government from local communities was not only instrumental in weakening the welfare state, but it has jeopardized the very survival of the Canadian federation. In contrast with what conventional wisdom would have us believe, the unity of a federation does not require a strong central government. Quite the opposite. Centralization is everywhere the enemy of harmony inside national communities, whether they be linguistic, ethnic, religious, or simply historical. Current threats to national unity in Canada are evidence that antagonisms rather than peace and social cohesion are likely to result from attempts by central authorities to engage in vast redistributive operations between regions and communities.

Such a situation is not limited to Canada. The collapse of centralist regimes in Eastern Europe and in the former Soviet Union should serve as a reminder that wealth redistribution by a central authority does not bring national or ethnic communities closer together. It is doubtful that the political integration of East and West Germany has yielded more advantages than would have been created by two distinct market-oriented economies with free movement of goods and factors (see Becker 1990). Subsidizing the continuation of inefficient uses of labor and capital in the eastern part is causing more conflicts than promoting national reconciliation. Whether in the former Soviet Union, Turkey, Canada, the former Yugoslavia, or in Europe as a whole, decentralization seems to be a major instrument to tame ethnic feuds. When minorities have more local autonomy within loose federations and more freedom of trade and movement across borders, they are less likely to feel oppressed and harbor hostilities. In effect, they

are more likely to assimilate freely into the larger wholes in the long run. Moreover, under free-trade regimes, large-scale migrations are made less necessary and less likely by movements of capital and goods.

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BOOK REVIEWS

Perfect Competition and the Transformation of Economics

Frank M. Machovec

London: Routledge, 1995, 391 pp.

Rarely does a book have the power to improve economists' fundamental vision of their subject. Frank Machovec's *Perfect Competition and the Transformation of Economics* is such a book. We've all seen dramatic testimonials on the covers of popular novels: "It grips the reader from the first page. . . can't put it down. . . a real page-turner." Most economists will feel the same about Machovec's work. It is genuinely exciting, one of the most important works in economics published in the past 10 years.

Machovec's thesis is that the profession's embracing of perfect competition constituted a Kuhnian revolution in which, tragically, the superior conception of competition as rivalry was overthrown. He establishes, first, that rivalrous competition dominated economics from the classical period to the early 20th century but that perfect competition dominates it now. This demonstrates that those who perceive a smooth continuum, incorrectly identifying classical competition as a crude attempt at perfection, misread doctrinal history and that a revolution did in fact occur. He then argues that, in several respects important to both theory and policy, the consequences of this revolution have been disastrous and that a return to rivalry and the method it requires would much improve our subject.

Readers acquainted with some controversies in the history of macroeconomic doctrine may notice a parallel. Although Kuhn wrote about the physical sciences, economists quickly applied his thesis to Keynesian macroeconomics. But what did this revolution overthrow? W. H. Hutt (1979) in *The Keynesian Episode*, Leland B. Yeager (1973) in "The Keynesian Diversion," and a number of other writers, including Henry Hazlitt, Ludwig von Mises, and Arthur Marget, have argued that pre-Keynesian theory was superior to that which replaced it. They perceived the reemergence, from the Keynesian morass, of pre-Keynesian truths, and predicted that the profession would eventually look back on "the Keynesian episode" with shame and embarrassment.