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Federalism and Decentralization: Ownership Rights and the Superiority of Federalism

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The benefits and costs usually ascribed to federalism are benefits and costs of decentralization; they are, therefore, present in unitary states that are in fact all decentralized. The benefits and costs specific to federalism pertain to ownership rights in constitutional powers. Federalism is superior to confederalism and unitarianism because the ownership rights peculiar to that system of government are such that they ensure the perdurance of competition when one or more competitors are unsuccessful. They do so because under federalism, powers cannot be repossessed unilaterally. Ownership rights have to be enforced; as a consequence, there are also costs that are specific to federalism.

Federal systems are, as a matter of definition, decentralized, but so are, as a matter of fact, all modern democratic unitary states; consequently, what distinguishes federal from unitary states is not decentralization. The pages that follow focus on the benefits and costs of federalism. In the fiscal federalism literature as well as in less specialized literatures on the subject, the benefits and costs that are imputed to federalism are, in effect, benefits and costs of decentralization. Being decentralized, unitary states therefore enjoy the benefits and pay the costs of the decentralization described in that literature more or less as do federal systems.

THE BENEFITS AND COSTS OF DECENTRALIZATION

Before turning to the benefits and costs ascribable to federalism and only to federalism, a brief review of some of the benefits and costs of decentralization is offered. A benefit that has been stressed in the fiscal federalism literature—especially the part of that literature which has sought to develop formal benefits models—is a presumed better match between the bundle of goods and services provided by governments and the heterogeneous preferences of citizens. The better match of preferences and supplies is seen by some as having its roots in interjurisdictional mobility as in Charles Tiebout's model—a mobility permitted by decentralization.¹ By others, it is

AUTHOR'S NOTE: I am grateful to Giorgio Brosio, Silvana Dalmazone, Pierre Salmon, and Anthony Scott for their comments on an earlier draft of this article. I alone, of course, carry responsibility for remaining errors.

¹Charles M. Tiebout, "A Pure Theory of Local Expenditure," *Journal of Political Economy* 64 (October 1956): 416-424.

seen in some innate greater responsiveness of junior governments to the preferences of people; by others still, it is seen in some greater motivation of local governments to seek to satisfy the preferences of their citizens.² More recently, it has been seen as originating in the greater control that citizens at local levels can exert on their political leaders through the ballot box.³ All of these virtues have to be qualified,⁴ but whatever the qualifications, the virtues pertain to decentralization, not to federalism *per se*.

A second benefit, often ascribed to federalism but which must again be imputed to decentralization, is an alleged greater propensity of governments to innovate more in decentralized than in centralized systems. To be more precise, the argument is that the risks associated with innovation are smaller for local governments; as a consequence, these governments will, other things being equal, have a greater incentive to innovate. As Susan Rose-Ackerman has shown, things are not necessarily that simple.⁵ A resolution of the debate between those who detect a greater propensity to innovate in decentralized systems and those who do not will help us appreciate the true value of decentralization, but will not make a contribution to our understanding of the benefits of federalism as such.

There is a third alleged benefit of decentralization, one that is also often imputed to federalism. At least since Alexis de Tocqueville, local governments have been seen as training grounds for liberty and democracy. Tocqueville thought that "local institutions are to liberty what primary schools are to science; they put it within the people's reach; they teach people to appreciate its peaceful enjoyment and accustom them to make use of it."⁶ John Stuart Mill, who acknowledged an intellectual debt to Tocqueville,⁷ especially on matters related to decentralization, stressed that participation in local affairs plays an important role in "the public education of the citizens."⁸ The argument is still

²Throughout, without loss of generality, all governments, except federal and national governments, are called local governments; state, provincial, cantonal, regional, and municipal governments, for example, are subsumed under the term "local governments."

³Paul Seabright, "Accountability and Decentralization in Government: An Incomplete Contracts Model," *European Economic Review* 40 (January 1996): 61-89.

⁴Albert Breton, Alberto Cassone, and Angela Frascini, "Decentralization and Subsidiarity: Toward a Theoretical Reconciliation," *University of Pennsylvania Journal of International Economic Law* 19 (Spring 1998): 21-51.

⁵Susan Rose-Ackerman, "Risk Taking and Reelection: Does Federalism Promote Innovation?" *Journal of Legal Studies* 9 (June 1980): 593-616.

⁶Alexis de Tocqueville, *Democracy in America*, trans., George Lawrence (Garden City, NY: Doubleday Anchor Books, 1969), p. 63. The original reads: "Les institutions communales sont à la liberté ce que les écoles primaires sont à la science; elles la mettent à la portée du peuple; elles lui en font goûter l'usage paisible et l'habituent à s'en servir." *De la démocratie en Amérique* (Paris: Librairie Philosophique J. Vrin, 1840/1990), Tome I, p. 50.

⁷See John S. Mill, *Autobiography* (London: Penguin Books, 1989), p. 150 where the acknowledgement in respect of decentralization is explicit.

⁸The complete sentence reads: "In an earlier part of this inquiry, I have dwelt in strong language—hardly any language is strong enough to express the strength of my conviction—on the importance of the portion of the operation of free [local] institutions, which may be called the public education of the citizens." From "Considerations on Representative Government," *Mill On Liberty and Other Essays*, ed., John Gray (Oxford: Oxford University Press, 1861/1991), p. 412.

used by such institutions as the World Bank as a way of encouraging the citizenry of developing countries to participate in politics.⁹ Again, however, the benefits must be attributed to decentralization and not to federalism as such.¹⁰

The costs of decentralization are also usually ascribed to federalism, though improperly. First, decentralization by itself is a source of interjurisdictional spillovers. Second, changes in the degree of decentralization—whether incremental or decremental—will generate what are, in effect, a particular sort of externality whenever constitutional powers¹¹ are complementary. Two powers are complementary whenever making use of one power calls for the utilization of the other. Let me illustrate what I mean by complementarity, given that the concept is relatively new as applied to decentralization and federalism. Because powers and, therefore, the complementarity of powers are always situation specific, my illustrations reflect Canadian constitutional arrangements. Example one: it is not possible to make certain decisions in the area of broadcasting—for example, to issue licenses to prospective broadcasters or to legislate in the matter of programming and content—without having to make decisions about the uses to which the airwave spectrum will be put; these two separate powers are then complementary. Example two: it is not possible to deregulate telecommunications—a concurrent power—without making decisions on matters related to cables and cable interconnections, a federal power in Canada. Example three: it is often difficult to legislate on matters related to pollution control—a provincial power—without negotiating international agreements, a federal power in Canada. Spillovers and externalities can be internalized through intergovernmental coordination, an activity that is costly.¹² There are other costs of decentralization besides coordination costs—among them, the costs of interjurisdictional mobility and the costs of signaling one's preferences—but the costs of coordination are, in all likelihood, the most important in constraining the extent of decentralization in governmental systems.¹³

As was the case with benefits, the above costs are costs of decentralization. They are not, in a strict sense, costs of federalism. To put it differently, the above costs have to be met by unitary states as well as by federal states and are not, therefore, specific to the latter.

⁹I thank Richard Bird, a colleague at the University of Toronto, for bringing this fact to my attention.

¹⁰I am grateful to Giorgio Brosio for reminding me of the importance given to local institutions by Tocqueville, for the reference to Mill's *Autobiography*, and for pointing out the recognition by Mill of Tocqueville's influence on Mill's thinking.

¹¹The expression "constitutional powers," used throughout, does not necessarily mean that the powers are explicitly entrenched in a written constitution. I use the term to identify all forms of authority that confer the right to design and implement policies in any particular domain.

¹²That coordination can play that role, and that it is costly, was first modeled by Albert Breton and Anthony Scott, *The Economic Constitution of Federal States* (Toronto: University of Toronto Press, 1978).

¹³Gary S. Becker and Kevin M. Murphy, "The Division of Labor, Coordination Costs, and Knowledge," *Quarterly Journal of Economics* 107 (November 1992): 1137-1160 have persuasively argued that in modern market economies, the division of labor is limited not so much by the extent of the market, as in Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (New York: Random House, Modern Library, 1937), Chapter 3, as by the costs of coordination.

THE BENEFITS OF FEDERALISM

It is important at the outset to remind ourselves that in respect of the problems posed by the division of constitutional powers, there are only three kinds of governmental systems: confederal, federal, and unitary. There can be variation within each group—federal countries differ among themselves as do unitary states—but there are, in essence, only three kinds of governmental systems.¹⁴

What is it that distinguishes one governmental system from another? The one factor that fulfills this role is the ownership of constitutional powers. Powers are owned more or less as capital assets are owned. If the power to design and implement policies in matters pertaining to education, for example, is assigned solely to state or provincial governments, these governments, individually or serially, can decide to maintain exclusive jurisdiction over education, to cede all or part of the power to another order of government, or to share the power with that other order of government—the so-called phenomenon of concurrency. As with property rights generally, ownership is not only circumscribed, it has to be policed and enforced at a cost.

In unitary states, whatever the degree of decentralization or whatever the extent of devolution of powers, all powers are *owned* by the national government; in confederal states, whatever powers may have been assigned to the central authority, all powers are owned by member states; and in federal states, some powers are owned by the federal government, while others are owned by the *Länder*, provinces, republics, or states.

I have defined the specificity of different governmental systems in terms of the ownership of powers on the assumption that ownership matters. One could have defined that specificity in terms of the day-to-day functioning of intergovernmental relationships, but such a strategy would have hidden the precise sense in which federalism differs from confederalism and unitarianism. For example, if the constituent units of confederal states “repossess” some or all of the powers they own, as they have historically always done, it is not because they are “jealous, clashing tumultuous commonwealths, the wretched nurseries of unceasing discord, and the miserable objects of universal pity or contempt” as

¹⁴The European Union (EU), as is often the case, poses a special problem in this connection because it is a governmental system that is neither fully confederal, fully federal, nor fully unitary. Article 3b of the Treaty of Maastricht, which defines the principle of subsidiarity, contains the following sub-sentence: “in areas which do not fall within [the community’s] competence. . .”, a statement which appears to say that those powers that had already been transferred to the Community in 1993 when the treaty came into effect are henceforth Community powers. This would imply that in respect of those powers, the EU is a federal system (see below). However, the EU’s central government in Strasbourg has been given only a power of disallowance, the positive powers being vested with the Council of Ministers, which is a confederal institution. One could take the position that the EU is a governmental system in transition toward a federal or a confederal equilibrium or, instead, opine that it is really a new type of governmental system. However that may be, I will have not more to say on the EU in this paper.

Alexander Hamilton wrote in *Federalist 9*.¹⁵ Although the constituent units of confederal states may very well behave as Hamilton says they do, they behave that way and reveal their so-called wretchedness because they are not constrained by a system of ownership that prevents them from repossessing powers unilaterally. In federal states, unilateral repossession is not possible.

What are the consequences of having different systems of ownership of powers and how does ownership help determine the benefits of federalism? To answer this question, we have to recognize that intergovernmental relations in all governmental systems are competitive. This is not to say that these relations should be competitive, but that, in the absence of collusion and other like interferences, they are competitive. Many individuals are hostile to this idea, less so today than ten years ago, but the hostility is still rampant. I note two reasons for this state of affairs in the hope that an awareness of the obstacles to seeing that intergovernmental relations are competitive will help nullify the effects of the obstacles. First, most economists and many non-economists remain subservient, often unknowingly, to the Benthamite or Welfare Economics view of governments as benevolent despots that, by nature, do whatever is necessary to counter market and other societal failures. If governments sometimes appear to be less beneficent than they (the Benthamites) assume they should be, they exhort them to behave as benevolent despots are thought to behave. Second, even though economics, at least since Adam Smith, has been importantly articulated on the notion of competition, economists know very little and care even less about the activities that are associated with competition and those that are not.

Consider the following three examples. If I submit a paper for publication, I will automatically be competing against all those who wish to publish a paper on topics that are somewhat related to that of my own, simply because space in journals is scarce. If someone is hired by a prime minister to act as his or her advisor on economic affairs, that person will be seen as a competitor by the Ministry of Finance, and rightly so. A few months before the publication of John Maynard Keynes's *General Theory* in 1936, James Angell published *The Behavior of Money*. It was a very good book. However good, though, the book could not compete against the *General Theory*; hence, it sank without a trace. The point of these three examples is that competition is often a product of the characteristics of the environment, more than of the intentions of decision-makers.

¹⁵Alexander Hamilton, John Jay, and James Madison, *The Federalist* (New York: Random House, The Modern Library, 1937), pp. 50-51.

In the case of intergovernmental relations, the available evidence is that these relations are competitive.¹⁶ In addition, the enormous literature proclaiming the virtues of cooperation between governments and exhorting them to be cooperative is indirect evidence of the competitive nature of these relations. To understand intergovernmental competition, we must distinguish between horizontal and vertical relations. Horizontal relations pertain to the relations of governments located at the same jurisdictional tier, while vertical relations concern relations of governments inhabiting different tiers. The mechanisms that drive horizontal competition have been uncovered by Charles Tiebout and Pierre Salmon, while no one has apparently studied the nature of the forces that govern vertical competition.¹⁷

The benefits of federalism derive from the operation of vertical competition. The Tiebout mechanism, which is entirely based on mobility of persons, can motivate horizontal competition, but it is not applicable to vertical competition simply because there is no such thing as vertical interjurisdictional mobility. As will become apparent shortly, the mechanism proposed by Salmon is fully general as it applies to both horizontal and vertical competition. Let me therefore briefly outline the Salmon mechanism for horizontal competition as an introduction to its use in vertical competition.

To make things simple, assume that there is no interjurisdictional mobility, governments located in different jurisdictions will not interact with each other and, one would seem obliged to conclude, will not compete among themselves. Salmon did not see it that way. He assumed,¹⁸ inspired by the then emerging economic theory of tournaments,¹⁹ that the citizens of a given jurisdiction would assess their own government's performance in respect of the provision of goods and services (as well as of other things) by comparing that performance to that of governments in other jurisdictions. That assumption opened the door to competitive interaction. Why? Because it then follows that citizens will reward their governing politicians

¹⁶Some evidence is presented in Daphne A. Kenyon, *Interjurisdictional Tax and Policy Competition: Good or Bad for the Federal System?* (Washington, D.C.: U.S. Advisory Commission on Intergovernmental Relations, 1991); Daphne A. Kenyon and John Kincaid, eds., *Competition among States and Local Governments: Efficiency and Equity in American Federalism* (Washington, DC: Urban Institute Press, 1991); and Albert Breton, *Competitive Governments: An Economic Theory of Politics and Public Finance* (New York: Cambridge University Press, 1996).

¹⁷Tiebout, "A Pure Theory of Local Expenditure." Pierre Salmon, "The Logic of Pressure Groups and the Structure of the Public Sector," *Villa Colombella Papers on Federalism*, eds. Albert Breton, Gianluigi Galeotti, Pierre Salmon, and Ronald Wintrobe, *European Journal of Political Economy* 3 (1987): 55-86; and Pierre Salmon, "Decentralization as an Incentive Scheme," *Oxford Review of Economic Policy* 3 (Summer 1987): 24-43.

¹⁸Salmon's first paper on the subject was published in 1987, but it was presented at a Villa Colombella Group Seminar in 1984.

¹⁹For example, Edward P. Lazear and Sherwin Rosen, "Rank-Order Tournaments as Optimum Labor Contracts," *Journal of Political Economy* 89 (October 1981): 841-864.

when their performance compares favorably with that of governing politicians in other jurisdictions and otherwise punish them. To put the matter differently, if we assume that governing politicians maximize an expected consent (or expected vote) function defined over goods and services (and other relevant things) and that citizens reward these politicians by granting them their consent (vote) when the comparison with the performance of other governments is favorable, then horizontal intergovernmental relations will, of necessity, be competitive.

It is reasonable to assume that, over time, governing and opposition politicians will learn that citizens are assessing their performance by comparing it to what is being done elsewhere. These politicians will, as a consequence, also observe the performance of their homologues in other jurisdictions and, knowing the reward-punishment algorithm, will seek to do better than these homologues. As a result, they will be competing with them.

To apply the Salmon mechanism to vertical intergovernmental relations, a further assumption is needed, namely, that the utility citizens derive from goods and services (including redistribution and regulation which are, in any case, also services) is sufficiently large not to be dominated by the utility these citizens may derive from the high regard in which they hold their provincial or regional government, or the esteem they accord their local leaders, or the preference they may have for a particular government supplying a given good or service irrespective of that government's ability as a supplier. In other words, if we can assume that the demand for goods and services reflects the value citizens derive from these goods and services and not mostly other considerations, then governing politicians at a given jurisdictional level will assess the performance of governments inhabiting other tiers. If they come to the conclusion that they can do better than these governments, they will act on that conviction. The competition that will result will lead to direct and/or indirect inroads and forays into supply domains which, either *de jure* or *de facto*, are occupied by a different order of government.

It is important in this connection to stress that powers, set down in constitutions and/or statutes and interpreted by the courts or given meaning by accepted conventions, are never defined completely and precisely. This means that inroads and forays in the supply domain of governments located at different tiers are, on *a priori* grounds, seldom fully prohibited *ex ante*.

Let me illustrate what I mean by inroads and forays in the supply domain—in the domain of powers—of other jurisdictions. The illustrations are inspired by American and Canadian experiences. Both the American and Canadian constitutions are clear that foreign affairs are the responsibility of the federal government. Many provinces and states, however, maintain establishments in foreign countries because they believe, no doubt correctly, that the promotion of certain of their local interests is best done by themselves. The Canadian Constitution is unclear concerning responsibility for

research. Until 1957, as regards the social sciences, the responsibility was taken to be part of the power over education and therefore provincial. In 1957, the federal government entered the field in a significant way. Some provinces have since reasserted their power in that area so that the power is now *de facto* held concurrently. In the United States, the power to regulate traffic on highways is a state power as is the power to define the minimum drinking age. In the 1970s and 1980s, Washington *de facto* set both speed limits on roads and minimum drinking age by attaching a speed limit and a drinking age as conditions for receiving federal grants. Lack of space prevents me from giving more examples. These three should be sufficient, however, to make the point that governments inhabiting particular jurisdictional tiers do invade domains of authority that do not belong to them and, in this way, compete with governments located at other levels.

Vertical competition is therefore usually accompanied by what, looking at it from the outside, appears to be duplication and overlap of responsibilities, though in reality, as in the marketplace, the competition is over near-substitutes, so that the duplication and the overlap are more apparent than real. What looks like duplication and overlap are, however, manifestations of actual vertical competition. The realities are also heralds or portents of potential vertical competition. In other words, they signal the ability and willingness of local governments to become suppliers of goods and services that are currently in the supply domain of senior governments should such inroads and forays increase the local governments' expected consent (vote). Conversely, duplication and overlap signal the capacity and willingness of a national government to become a provider of goods and services whose supply has hitherto been restricted to local governments, should that be to its advantage.

No one likes to be undersold or outdone in competitive struggles. That dislike is sometimes so intense that when internalized norms no longer elicit social or civilized responses to competitive defeat, laws and regulations have to be put in place to prevent those who have been undersold and outdone from engaging in reprisal, revenge, and/or retaliation of a sort not consistent with the *ex ante* rules of the game. The laws and the regulations are part of the system of ownership rights. Governing politicians and their bureaucrats do not like competitive defeat either.

The system of ownership rights entrenched in federal constitutions ensures that the dislikes that result from being undersold or outdone do not lead to a termination or to a severe attenuation of competition. It is this reality which makes federalism superior to confederalism and to unitarianism. To appreciate this point, it suffices to recognize that if a government located at a given tier successfully invades the supply domain of governments inhabiting another tier by supplying, at given tax-prices, goods and services in quantities and qualities that better match the preferences of

citizens, the governments whose supply domain has been invaded will be tempted to retaliate. With the ownership rights entrenched in confederal and unitary constitutions, retaliation can easily take—and historically has often taken—the form of a repossession of powers. If the repossession is complete, competition will be extinguished altogether.

It is true that in federal states, unsuccessful competitors may seek to secede from the federation. A successful secession is like a repossession of powers; it too extinguishes competition. In the normal course of affairs, ownership rights will evolve smoothly, though the parties involved in the game and the citizens who have faint hearts may not experience the evolution in that way. In the last analysis, the superiority of federalism over other kinds of governmental systems rests on the reality of a system of ownership rights that in general (barring secession) makes unilateral action, in regard to the assignment of constitutional powers, impossible. The relative efficiency (comparative advantage) of differentially located governments at supplying goods and services which drives the mechanism that assigns powers cannot be unilaterally and arbitrarily crippled in federal states, whereas that possibility cannot be ruled out in confederal and unitary states.

One aspect of the above argument must be elaborated. Collective decisions and the resolution of collective problems will often require the exercise of political power. Power, however, is easily abused. In confederal, federal, and unitary democratic systems, abuse is controlled by checks and balances. However, the checks and balances that are attributes of decentralization are entrenched only in federal states. That is why it is correct to say that federalism is an extension of democracy, as are such institutions as the separation of the executive and the legislative from the judiciary and the existence of a Bill of Rights or of a Charter of Rights and Freedoms.

EVOLUTION, PATH DEPENDENCE, AND STABILITY

The foregoing discussion has led to the conclusion that federalism is superior to confederalism and unitarianism; it is, therefore, natural to ask why all democratic governmental systems are not federal. As part of the same inquiry, we can also ask whether all governmental systems will eventually adopt federal constitutions.

The idea that governmental systems are driven by evolutionary forces is not new. Tocqueville,²⁰ James (Lord) Bryce,²¹ Johannes Popitz,²² and Harold

²⁰Tocqueville, *Democracy in America*.

²¹James Bryce, *The American Commonwealth* (New York: Macmillan, 1911).

²²Johannes Popitz, "Der Finanzausgleich," *Handbuch der Finanzwissenschaft* (Tübingen: 1927). Popitz's writings are in German and, as far as I have been able to ascertain, not translated. I, therefore, have had only indirect access to his thoughts through Emilio Gerelli, "Intergovernmental Financial Relations: The Case of the German Republic," *Weltwirtschaftliches Archiv* 97 (1966): 273-302, and Horst Hanusch, "Tendencies in Fiscal Federalism," *Secular Trends of the Public Sector*, ed., Horst C. Recktenwald (Paris: Cujas, 1978): 129-149.

Laski,²³ among others, all pointed to evolutionary tendencies in governmental systems. Tocqueville wrote: "I think that in the dawning centuries of democracy—centralized government will be the natural thing."²⁴ Because of the importance of Bryce's work, not only as a weighty treatise but also as a source of guiding principles in the formation, for example, of the Australian federation, his assertion that federalism was "simply a transitory step on the way to governmental unity" has so often been quoted that it has acquired a life of its own.²⁵ Popitz also perceived a drift toward centralization through what he called the "force of attraction of the highest budget."²⁶ Laski, speaking in New York early in 1939, declared that federalism, which he recognized had had an existence in days gone by, was, appearances notwithstanding, already dead.²⁷ All these writers in effect conceived unitary states as the superior form of government.

To understand the nature of the evolutionary process, it is important to remember that in all societies, the system of rights which governs the ownership of constitutional powers and which, as a consequence, determines the character of the governmental system is a product of particular historical circumstances and of chance events, with sometimes a dominance of the first and sometimes of the second. For example, Canada might not have been a federation had it not been for the historical facts that Quebec was largely French-speaking and that Ontario was, to a significant degree, populated by United Empire Loyalists who had fled the United States at the hour of its independence to remain faithful subjects of the British Crown. These two pieces of historical data conjoined with the chance event that the United States, in the dying days of a murderous civil war²⁸ but still trigger happy, was seen by many north of the 45th parallel as ready and willing to pursue its "manifest destiny" into the territory that was to become Canada. Forces for union, therefore, were instrumental in convincing a reluctant John A. Macdonald to join forces with Georges-E. Cartier and to give a

²³Harold J. Laski, "The Obsolescence of Federalism," *The New Republic* 98 (May 1939).

²⁴Tocqueville, *Democracy in America*, p. 674. The original reads: "Je pense que dans les siècles démocratiques qui vont s'ouvrir—la centralisation sera le gouvernement naturel," *De la démocratie en Amérique* Tome II, p. 245.

²⁵Bryce, *The American Commonwealth*, Vol. 2, p. 906, goes on to say that "it may therefore be concluded that while there is no present likelihood of change from a Federal to a consolidated republic [in the United States], and while the existing legal rights and functions of the several States may remain undiminished for many years to come, the importance of the States will decline as the majesty and authority of the National government increase." In other words, for Bryce, the "transition" was already under way.

²⁶Gerelli, "Intergovernmental Financial Relations," 273.

²⁷For a more elaborate discussion of these views and of others (those of Albert Dicey, Henry Sidgwick, and Kenneth Wheare)—all, without a single exception, views of citizens of unitary states—as well as for a summary of the empirical literature on trends in the evolution of federal systems—trends that point to decentralization—see Albert Breton, *Centralization, Decentralization and Intergovernmental Competition: The 1989 Kenneth R. MacGregor Lectures* (Kingston, ON: Queen's University, Institute of Intergovernmental Relations, 1990).

²⁸The first meetings to discuss the formation of a Canadian federation were held in 1864. The American Civil War ended in 1865.

federal form of government to Canada.²⁹ Why Italians decided not to write a federal constitution at the end of World War II is not so much to be explained by the historical circumstance of having experienced a unitary form of government under monarchy and dictatorship, as to the chance events of (1) the rise of a broad-based Communist party that would have been elected and would have formed the government in many of the country's regions had Italy been federal, and (2) the formation of the Christian Democratic party under the aegis of Alcide De Gasperi and the Vatican.

Given the initial conditions forged by history and chance events, the evolution of ownership rights (and of governmental systems) is necessarily path dependent and may exhibit lock-in. Although these expressions are of recent vintage, an important part of the reality which they capture was already known to Alfred Marshall for example.³⁰ A path-dependent sequence of events is one in which "important influences upon the eventual outcome can be exerted by temporally remote events, including happenings dominated by chance elements rather than systematic forces."³¹ Path dependence implies that if two countries or societies initially have similar systems of government, there is a positive probability that at some given future historical date, they will have *different* governmental systems and therefore different ownership rights in respect of constitutional powers.³²

Lock-in means that it is difficult—not impossible (see below)—to exit from a given situation. That will happen whenever the selection that gets established accumulates a self-reinforcing advantage which then acts as a barrier that can forestall "escape" to other possible selections. For Marshall discussing "the concentration of specialized industries in particular localities,"³³ or for contemporary scholars preoccupied with explaining technological adoption,³⁴ the sources of self-reinforcing advantage and, therefore, of lock-in are increasing returns, external economies, strategic complementarities, and other like realities.

In the case of governmental systems and of the ownership rights that define them, the self-reinforcing advantage that begets lock-in could be called "tradition." Given self-reinforcement, tradition is a reality that obviously changes with the passage of time. That is an important characteristic of tradition, but there is another characteristic, more important for the

²⁹Macdonald and Cartier were the driving forces behind the efforts to create a federation. Macdonald became Canada's first prime minister in 1867.

³⁰Alfred Marshall, *Principles of Economics* 8th ed. (New York: Macmillan, 1952).

³¹Paul A. David, "CLIO and the Economics of QWERTY," *American Economic Review* 75 (May 1985): 332.

³²Without path dependence, governmental systems and their defining ownership rights, which might have been identical at the start and might have evolved identically over time, may nonetheless come to be different as a result of a severe trauma such as a foreign invasion.

³³Marshall, *Principles of Economics*, Bk IV, Ch. X, p. 267.

³⁴See, for example, W. Brian Arthur, "Competing Technologies, Increasing Returns, and Lock-in by Historical Events," *Economic Journal* 99 (March 1989): 116-131.

matter under analysis, which we could call the “weight” or authority of tradition. For any system of government, tradition embodies the “constitution,” accumulated jurisprudence, ruling doctrines of constitutional interpretation, accepted norms regarding litigation and negotiation in matters concerned with constitutional ownership rights, prevailing customs and protocols relating to the behavior and role of the bureaucracy, conventions governing control over relevant information, and so on.

The matter can be looked at from a different perspective. Consider a given confederal system of government. (I choose a confederal system because no such state has existed for over 200 years and, as a consequence, irrelevant empirical details are less likely to distract the reader from the point.) Suppose that in the absence of disturbances, the governments of that confederal system, under the ownership rights and a division of powers entrenched in a “constitution,” provide, at given tax-prices, goods and services (including redistribution) in quantities and qualities that maximize the consent (vote) they expect citizens to grant them. In respect to the ownership rights and the division of powers which they sanction (as well as the provision of goods and services), this particular confederal system is in stable equilibrium. A different division of powers (and, therefore, a different supply of goods and services) would reduce the expected consent granted by citizens to the governments of the system. As a consequence, under conditions to be spelled out immediately, we should expect the system to return, after a period of time, to its initial equilibrium position.

All divisions of powers, different from the initial equilibrium division, which converge to the initial division over time can be said to be in the basin of attraction of that initial equilibrium. What, then, are the conditions that will ensure a convergence to the original equilibrium? Put differently, what are the conditions that determine the “size” of a basin of attraction? The size of a basin of attraction is a measure of the “flexibility” of a given governmental system and of the ownership rights that shape its character. It tells us how large a perturbation can be imposed on the system without affecting its tendency to return to its original configuration. All divisions of powers that reduce the expected consent granted to governments by their citizens will incite these governments to adopt corrective measures. All such measures have to be designed and implemented in a context that is defined by tradition. The greater the weight of tradition, the greater the degree of convergence to the original configuration and, therefore, the greater the degree of stability. Put differently, the greater the weight of tradition, the higher the barriers separating different basins of attraction—different governmental systems—and, at the same time, the greater the size of a given basin.

Stability of governmental systems and of ownership rights does not mean that it is impossible for a system to exit from a lock-in situation or from a

basin of attraction. It is possible, following an important disturbance or a series of sustained random shocks, for a confederal system of government to tip over from its basin of attraction into a federal or a unitary basin of attraction. If the weight of tradition is small, or at the limit barely felt, it is conceivable that following a severe perturbation, a governmental system will be radically transformed. It will move from one equilibrium system of ownership rights to another. Let me illustrate with two cases: one historical, the other hypothetical.

It can reasonably be argued that prior to the U. S. Civil War (1861-1865), there was enough uncertainty regarding the nature of the ownership rights governing the division of constitutional powers between the federal government and the states that the weight of tradition was not very great. Consequently, it was possible for those so inclined to give a confederal twist to many parts of the republic's basic law. The Civil War—a mistake or chance event—flipped the system of government from a basin of attraction in which the equilibrium system of ownership rights in respect of constitutional powers was weakly confederal to one in which the equilibrium was more strongly federal. The tipping from one basin of attraction to the other is nicely captured by the historical fact that “up to the Civil War, ‘the United States’ was invariably a plural noun: ‘The United States are a free government,’ After Gettysburg [Lincoln’s Gettysburg Address], it became a singular: ‘The United States is a free government’.”³⁵

The hypothetical case concerns Canada. Quebec secessionists—except for a fringe of true believers—want secession from Canada accompanied by an “association” or “partnership” with Canada.³⁶ They are, in effect, confederalists.³⁷ What they contemplate is a confederation constituted of Quebec (as a unitary state) and of Canada (as a federal country made up of nine instead of ten provinces). It is easy to imagine mistakes or random events that would flip the country out of its current federal basin of attraction, in all likelihood through the crucible of a civil war, into another basin of attraction.

The burden of the foregoing discussion is that because the selection of a governmental system is the result of a process that is sensitive to initial con-

³⁵Garry Wills, *Lincoln at Gettysburg: The Words That Remade America* (New York: Simon and Schuster, 1992), p. 145.

³⁶That helps explain why 25 percent of the Quebecers who voted for secession in the October 1995 referendum believed that once secession had been achieved, they would continue to carry a Canadian passport, use Canadian currency, elect representatives to the Canadian Parliament, bring cases to the Canadian Supreme Court, and so on.

³⁷Outside Quebec, in the rest of Canada, there are some people—a good number of them academics—who hold to the view that, in Canada, all powers or most of them (some exceptions are defense and international diplomacy) should be owned by the provinces. These people do not state their position in the language of ownership, only because they lack the conceptual apparatus that would permit them to do so. Like most Quebec secessionists, they are confederalists and act as a “fifth column” for the Quebec secessionists. Indeed, they are seen as such by the latter.

ditions, and because of the presence of a set of forces—that I have labeled tradition—which contribute to impart to a given governmental system a self-reinforcing advantage over alternative systems, a particular selection can perdure without necessarily being “optimal” in a global sense. One would have to wait for significant disturbances or for the cumulative effect of repeated random shocks for a governmental system to tip over into another stability domain. But again, there is no guarantee that the closest attractor would be first best.

THE COSTS OF FEDERALISM

The costs of federalism are simply the costs of policing and enforcing the ownership rights that pertain to the assignment of powers. Vertical competition takes the form of actual and potential inroads and forays into the supply domains of governments located at different jurisdictional tiers. Policing and enforcing ownership rights in that context simply means that the inroads and forays can be defended on the basis of cost advantages and, ultimately, on the basis of the welfare of citizens. But defended where and by whom? Or, put differently, who will actually police and enforce ownership rights in regard to constitutional powers? In markets, business corporations, not-for-profit institutions, or marriages, for example, property rights are policed and enforced, to a considerable degree, by governments. In civil society, however, there is no authority above governments. A discussion of the costs of federalism, therefore, cannot avoid asking the question of who polices and enforces ownership rights in federal systems. The answer is that national governments do. But these governments are players in vertical intergovernmental competition. Decimus Juvenal’s famous question as to who shall guard the guardians must be addressed.³⁸

Although there is enormous variation in the way different federal systems deal with the fact that national governments are at once player and judge, all have recognized, albeit sometimes unwittingly, that the answer to Juvenal’s question is to be found in the way the national governments of federal systems are designed. I mention two equally important features of these designs. First, there is the existence of independent judiciaries which act to guarantee that central authorities do not behave in an arbitrary fashion.³⁹ Second, there is the genuine presence of the *Länder*, provinces, republics, or states that constitute a given federation in the decision-making of national governments.

³⁸See Decimus J. Juvenalis, *Satires*, Translated by Jerome Mazzaro (Ann Arbor: University of Michigan Press, 1965). The original reads: “Quis custodiet ipsos custodes?” *Satire VI*, Verses 347 and 363. Though it has become conventional to apply Juvenal’s question to politics, he himself posed the question after writing: “Lock your wives in.” Book VI is indeed a satire against women and marriage.

³⁹I am grateful to an anonymous referee for stressing the importance of independent judiciaries.

In both the United States and Canada, the judiciaries have historically acted to prevent governments located at one level from capriciously invading the powers of governments inhabiting other tiers. The fathers of the American Constitution invented federalism by creating a Senate in which all the states are represented equally, thus ensuring a presence of the states in decision-making in the national arena. Until 1913, that was done through the appointment of two senators by each state legislature and, after 1913, through the election of two senators in statewide contests. Other federations have followed in the American footsteps. The American solution to Juvenal's problem is on the whole a good one, although it was not good enough to prevent the Civil War.

The Canadian answer to Juvenal's question, though unique and interesting in a backhanded sort of way, is very much second best. The Canadian federal government is made up, like the United States government, of two chambers: a House of Commons and a Senate. However, the Canadian Senate is more like the British House of Lords than like the American Senate. Canadian senators do not and cannot represent the interests of the provinces because, except for those from Ontario and Quebec, they are appointed on a regional basis, where regions are aggregations of provinces. The Senate's inefficient design is repeated throughout the federal government. However, by ensuring regional representation not only in the Senate but also in the Cabinet, in the Supreme Court, and in other large centers of power, such as the central bank and a number of specialized tribunals, successive governments in Ottawa have given a presence of sorts to the interests of the provinces in national decision-making. The design is only second best and has no doubt allowed inroads and forays into the supply domains of the provinces that, from an efficiency point of view, were excessive. There is an enormous Canadian political science literature on the subject, which, under the name of "intrastate federalism," has come to more or less the same conclusion.⁴⁰

CONCLUSION

The benefits and costs that the literature ascribes to federalism are really benefits and costs of decentralization and are, therefore, also present in unitary states all of which are, as a matter of observable fact, decentralized. The benefits and costs that are specific to federalism pertain to ownership rights regarding constitutional powers. Federalism is superior to confederalism and unitarianism, however, because the ownership rights that are peculiar to that form of government are such that they ensure the

⁴⁰Donald V. Smiley, "The Structural Problem of Canadian Federalism," *Canadian Public Administration* 14 (Winter 1971): 326-343 and Alan C. Cairns, *From Interstate to Intrastate Federalism*, Discussion Paper No. 5, (Kingston, ON: Queen's University, Institute of Intergovernmental Relations, 1979).

perdurance of competition when one or more competitors are unsuccessful because, under federalism, powers cannot be repossessed unilaterally and arbitrarily. Even if federalism is superior to other forms of governmental organization, evolutionary forces will not necessarily lead unitary and confederal systems toward federalism because of path dependence and lock-in effects. Ownership rights have to be policed and enforced; as a consequence, there are also costs specific to federalism.