FEDERALISM: THE REASONS OF RULES

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As the next millenium draws near, problems of freedom, governance, and public policy around the globe increasingly have become problems of federalism. In the Soviet Bloc the historically identifiable nations of Eastern Europe have moved from colonial status to an emerging independence. Even in the Soviet Union itself, the Baltic states and separate Soviet republics now seek to loosen the bounds of central control. The nations of Western Europe are stumbling toward greater centralization, by constructing the confederation promised by Europe 1992 (Aranson 1989). Canada struggles with the federal terms of its constitution. And we in the United States, as we have done for nearly all of our national experience, interpret our political and social conflicts in terms of our federal arrangement.

In this universe of discourse, the problem of establishing "models" of federalism, and then of discerning each model's advantages and drawbacks, provides the core of argument. This essay is no different in that regard. So here I first explain that federalism before the American Constitution differed from the Constitution's federalism. And the Constitution's federalism differs from our contemporary understanding of what federalism requires. Early federalism was a matter of individual or personal virtue. The Constitution's federalism, which, following Martin Diamond (1969), I shall call *constitutional decentralization*, was a matter of legal doctrine. And our present understanding of federalism, which I shall call *contingent decentralization*, is wholly utilitarian.

I shall argue, however, that utilitarian federalism cannot survive, for reasons of ignorance and politics. I then explore the Supreme

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Court's shifting interpretation of federalism from doctrine to utilitarianism, to show that indeed, a utilitarian interpretation of federalism ultimately implies its demise. I then argue in closing that only a doctrinal interpretation and defense of federalism can secure its future and, therefore, its personal and utilitarian virtues.

Background to American Federalism

The term "federalism" comes from the Latin root "foedus," meaning "covenant" (Elazar 1987, Ostrom 1989). The "federative" powers of a state, as Locke called them, were those given to rulers, to form agreements with the heads of other states, to ensure nonaggression and mutual protection. So before its American development, federalism referred more to a form of international relations (Diamond 1969), and less to a constitutive organization of local governments or territories under a central power.

This early construction of federalism invoked an ancient concern about the state's appropriate size. For the Greeks a state must be self-contained and sufficiently small to allow each citizen meaningfully to partake in its political life, thereby gaining a full measure of self-actualization. "Man," Aristotle said, "is a political animal," by which he meant not to describe people as they are, but as they could become if the state were small enough to allow for full political participation and, therefore, the achievement of the *telos* or goal of human nature.

By Montesquieu's time, concern for the state's appropriate size had shifted in two ways. First, for a state to survive, it had to be somewhat larger than the Greek *polis*. But second, in the new, larger republic, size must remain limited not for purposes of *internal* self-actualization, but to achieve the *external* benefits of individual "republican virtue," without which the state also might perish. For Montesquieu (1949, p. 126), the essential tradeoff became: "If a republic be small, it is destroyed by a foreign force; if it be large, it is ruined by an internal imperfection."

The Framers of the American Constitution remained impressed with Montesquieu's two-fold argument. But again the core justification had shifted with respect to its ultimate objects. First, the Framers were not content to rely on republican virtue, for they did not believe in its constancy. "The latent causes of faction are . . . sown in the nature of man," said Madison (*Federalist* No. 10). Humanity's history provided ample evidence of "little, jealous, clashing, tumultuous commonwealths," offering the spectacle of "the wretched nurseries of unceasing discord," wrote Hamilton (*Federalist* No. 9). And there-

fore, as Madison summed up, "ambition must be made to counteract ambition" (*Federalist* No. 51).

Second, the Framers' principal concern remained with preserving the former colonies against foreign aggression (Riker 1964, chap. 2; 1987; n.d.). The peace with Great Britain was an uneasy one, with British forts strategically located in the Northwest Territories. Spain held the Southwest and some of the South, and Kentucky actually considered joining Spain. "The Country," said Gouvernor Morris, "must be united. If persuasion does not unite it, the sword will" (Farrand 1937, p. 530).

It is a close question whether the Framers, and particularly Madison and Hamilton, in constructing their peculiarly American version of federalism, yielded to logical argument or to political necessity. Logical argument recommended Montesquieu's version of federal relations—a confederation—among reasonably small republics, brought together to ward off foreign design. The tenacity with which the states held to their independence and sovereignty likewise recommended such a course from political necessity.

But a strong case had been made against the Articles of Confederation, which had embraced Montesquieu's model of federalism. First, several of the state governments appeared to be internally disordered, given to democratic, legislative excesses resulting in the abrogation of contracts and (to the same effect between debtors and creditors) the inflation of state-issued currencies. Second, interstate trade wars seemed to be real possibilities, as particular states allegedly took actions that weakened the continental common market. Third, the want of a robust national taxing power threatened the states' abilities to raise and maintain armies and navies for mutual protection.

As overdrawn as this case seems in retrospect (Jensen 1940; Kitch 1981; Aranson 1989), it nevertheless suggested a stronger form of union, especially where the federative, military, and treaty-making powers were concerned. But the stubborn independence of the states remained an unchangeable reality with which the Framers had to contend. The result of these forces was a peculiarly American invention, not since duplicated in any large state, an invention that Diamond (1969) called "constitutional decentralization."

Contingent versus Constitutional Federalism

To grasp the full nature of this invention, we must set aside the usual dimension along which we ordinarily measure federalism, namely, that running from decentralization to centralization. Certainly, we can identify the change that the Constitution of 1789

wrought in the new nation's position on this dimension: Governance became relatively more centralized. Just as certainly, most Americans, and nearly all economists (Oates 1977) today regard federalism as being merely some degree of decentralization. But that characterization obscures, indeed misconstrues, the invention's real nature. Under constitutional decentralization the degree of centralization (or decentralization) was fixed in particular ways by the law of the Constitution, reserving permanently to the states a measure of sovereignty wholly absent in today's definitions of federalism.

Stated differently, in today's discourse the degree of centralization or decentralization in a federalism locates all sovereignty in the central government. That government then decides, as a matter of prudential or political judgment, how much authority to devolve to the constituent units. The closest version we have to this concept of federalism today occurs in the relations of cities and counties to state governments, which control not only the extent and limits of local government authority, but sometimes even their very boundaries. The result is a degree of decentralization contingent on the central power's choices.

Federalism as *constitutional* decentralization differs from federalism as *contingent* decentralization in that the authority of the states under constitutional decentralization is guaranteed as a matter of organic, constitutional law. Neither prudential nor political judgments or decisions taken at the national level can overturn such guarantees in the face of appropriate legal fidelity to the original constitutional arrangement. To grasp the full implications of this difference between federalism as constitutional decentralization and federalism as contingent decentralization, we must compare the two concepts in operation, under two competing hypotheses.

Federalism and Public Interest

The first hypothesis—the public-interest hypothesis—is that most familiar to economists in writings about the state in general, and about federalism in particular. The core notion holds that governments emerge in human communities to address a set of problems that market relations may find difficult to resolve. These include the definition and protection of rights in person, property, and contract, the production of public goods, the suppression of "public bads," the provision of external benefits, and the regulation of market power.

When applied to the construction of a federal arrangement, the public-interest hypothesis raises three distinct, though overlapping considerations. The first concerns the level at which one or more of these problems occurs. For example, the "catchment" of national

defense or international treaty making may be the entire nation, requiring that all or most such decisions be taken at the national level. But the catchment of most road construction, or crime or property law, may be confined to smaller units, recommending that all or most such decisions be taken at the local level. In short, the efficient level and pricing of one or more of these activities may best be chosen at different jurisdictional levels.

Failure to get this matter right can have unfortunate consequences. For example, if taxpayers nationally must pay for Atlanta's public transportation system, then Atlanta will spend too much for its system. And if, by contrast, decisions are made solely in Ohio concerning air pollution generated there but afflicting Eastern states, then Ohio will not adopt the "correct" level of pollution abatement. The general rule is that people must bear the costs of that from which they benefit, and that they must have a right to avoid, or to gain compensation for, the costs that others impose on them.

The second consideration involves economies and diseconomies of scale. In theory, one can expand indefinitely the catchment of a producer of a pure public good, thereby reducing the cost of output per person served. But such goods rarely occur in nature. National defense may provide an imperfect example. A public statue might inspire those who view it. But as the size of the audience increases, crowding and other local aspects become more readily apparent.

Economies and diseconomies of scale more directly affect the production process itself. The optimal size of a school district, for example, is probably much smaller than that which most jurisdictions adopt. Optimum scale occurs at the output where average total cost is minimized, which in turn is the output at which the change in the economies of scale is exactly equal (but of opposite sign) to the change in the diseconomies of scale. Jurisdictional boundaries, therefore, should be adjusted until each jurisdiction provides its output at optimal—least cost—levels.

The third consideration involves what economists call "Tiebout forces" (Tiebout 1956). Getting people to reveal their preferences for public goods or services that exhibit jointness of production and supply is always problematical. People can report that a particular production level is worth little to them, and thereby avoid taxation based on a benefit principle. This is just another variation of the free-rider problem. In addition, to the extent that production becomes centralized, few competitive forces remain to ensure the discovery and adoption of efficient methods of supply.

The Tiebout hypothesis envisions constructing competing jurisdictions and allowing people to reveal their preferences by "voting

with their feet." The underlying logic is that people will sort themselves out among jurisdictions that best provide the mix of goods and services that they prefer. Improvements in governmental performance will be capitalized into land prices, thus giving citizens and public servants incentives to act in appropriate ways. Other jurisdictions will emulate successful innovations and avoid failures. In short, the Tiebout hypothesis supposes that it is possible to "make a market" in the competitive supply of local public goods and services.

The public-interest hypothesis thus entails these separate considerations, carried on at different levels of analysis. First, the public sector will confine itself to perform all and only those tasks that have public-interest credentials. Second, the central government will adjust the boundaries and empowerments of lower levels of (subordinate) governments, to accomplish those tasks with a due regard for catchment, scale, and competitive forces. This is what federalism as contingent decentralization means. Stated differently, the national government decentralizes decisionmaking in precisely the same way as would a private sector firm, with the understanding that the full authority to decide on the degree of decentralization remains with the central power.

Federalism as constitutional decentralization tends to disregard these welfare-promoting reasons for decentralization and instead adopts a decentralization as a matter of right and, consequently, of legal doctrine. The difference between constitutional and contingent decentralization, therefore, is that the virtues of decentralization happen, if at all, by design under the first and by felicitous accident under the second.

To the extent that American federalism entails constitutional decentralization, however, we might ask why it is ever a better idea than contingent decentralization. The answer lies partly in the central government's inability to get the tasks and boundaries right. Planning tasks and jurisdictions requires all of the information that would be required to plan an economy itself. That information, as Hayek (1945) and others have argued, is widely and radically decentralized among the citizenry. Hence, it seems doubtful that the central planning-economic calculation problem, which no one has solved with respect to production, could be solved with respect to the far more difficult problems of public goods, services, and jurisdictions.

But we can claim more than that the central government's decisions in these respects simply remain wrong, and probably random. Instead, even under the assumptions of benevolence that characterize the public interest hypothesis, it seems likely that the central

government's information will be biased systematically toward appreciating the *benefits* of increased centralization and the *costs* of increased decentralization. Central decisionmakers, after all, will know their own costs and benefits, but not those of decentralized decisonmakers, including the subject citizens themselves. This is simply another application of the theory of "rational ignorance" (Aranson 1989/1990).

Federalism and Private Interest

The second hypothesis holds that governments are concerned less with the allocative chores of the public interest hypothesis and more with the distributive consequences of public policy: Who gets what? This is the rent-seeking model of the political process (Tullock 1967; Krueger 1974; Stigler 1971; Peltzman 1976; Aranson and Ordeshook 1985; Weingast, Shepsle, and Johnsen 1981). Its earliest development entailed the notion that government treats firms in a competitive industry as a cartel, regulating output and entry accordingly. A welfare—deadweight—loss results, along with the production of rents that the political process itself dissipates. Hence, politics becomes wasteful, welfare-degrading, and not at all involved in the processes that the public interest model would contemplate.

Macey (1990) recently has applied this model to the problem of federalism. In his interpretation, government finds it easier to provide rents from regulating some activities at particular jurisdictional levels than at others. For example, if individual state governments sought through compulsory union membership to cartelize labor markets, those states that did not follow this course would attract and keep lower-cost producers to the disadvantage of producers in unionized, high-cost states. Hence, under the rent-seeking model labor-market cartelization should (and does) occur at the national level. Consumers in markets for medical care and legal services, by contrast, are relatively more immobile than are consumers in ordinary product or factor markets. So, local regulation, more easily than federal regulation, can (and does) maximize rents by taking cognizance of local conditions concerning these services.

Changing technology alters the preferred locus of political control in both the public interest and private interest, rent-seeking models. For example, advances in data processing and transmission make it possible for banking and securities transactions increasingly to occur over ever-wider geographical areas. The locus of concerns for financial stability will expand in the public interest model, and the locus of concerns for rent provision will likewise expand in the private interest model.

The normative conclusions derived from each model in the face of such technological changes, however, remain wholly different. If we ignore the problem of information and its bias, we would prefer the superior responsiveness of federalism as contingent decentralization if we believed that government acts principally in accord with the public interest model. But we would prefer the "rigidity" of doctrine associated with federalism as constitutional decentralization if we believed that government acts principally in accord with the private interest model. Knowing which model applies thus becomes crucial for uttering a preference for one form of federalism over the other. If both models find occasional application, of course, then the matter becomes that much more difficult. To get a sense of which model *does* apply, we turn to the historical record.

The Supreme Court's Federalism

The Constitution's Constitutional *Decentralization*

Whether or not they *should* have done so, the Framers designed a constitutional decentralization, not a contingent one. Indeed, this choice almost certainly reflected their intuitive understanding, as expressed throughout the *Federalist Papers*, that the animating spirit of government action all too often gives evidence of the pursuit of private interest.

The Constitution itself sets out in Article I, Section 8, a collection of "enumerated" national government powers, including the traditional federative (national defense and international relations) powers and the "Power . . . to regulate Commerce with foreign Nations, among the several States, and with the Indian Tribes. . . ." The draftsmen took great pains to avoid congressional favoritism among the states in matters of trade and taxation. And they drew equally clear lines to avoid state actions in derogation of the national common market. Finally, the Tenth Amendment required that "The powers not delegated to the United States by the Constitution, nor prohibited to the States, are reserved to the States respectively, or to the people."

The Constitution's allocation of substantive powers and that provided under the Articles of Confederation are not materially different. But the Constitution also created a national executive and more robust taxing powers. It departed from the Articles' legislative decision rule (nine of thirteen states, each with one vote) to embrace majority rule with a two-house legislature, plus a potentially overridable executive veto. The Union was on firmer ground, of course, as the Constitution's supremacy clause made clear. But the overall structure of the document with respect to domestic concerns created

enumerated national powers "in the sense of being islands of authority in a sea of state and individual power." But with respect to federative concerns, the "powers of individual states were likewise severely limited, becoming even smaller islands of authority in a sea of national powers" (Aranson 1990). Madison expressed well the Constitution's plan of divided authority, in *Federalist* No. 14:

> The general government is not to be charged with the whole power of making and administering laws. Its jurisdiction is limited to certain enumerated objects, which concern all the members of the republic, but which are not to be attained by the separate provision of any. The subordinate governments, which can extend their care to all those other objects which can be separately provided for, will retain their due authority and activity.

The American Constitution, however, shares a problem with all other written organic documents: It is not self-enforcing. Or, as Madison again put it in *Federalist* No. 18, the Constitution provides but a "parchment barrier . . . against the encouraging spirit of power." It thus remained for the Supreme Court to lay out the metes and bounds of national and state powers, both with respect to each other and with respect to the individual citizen. This activity occurred over the intervening centuries as the result of a large number of suits, involving the federal government against a state, a state against the federal government, or either of these against an individual citizen, or vice versa. Each suit brought to the Court a claim or counterclaim, that the national or a state government had exceeded its powers absolutely, or had done so with respect to the rights or powers of another person or government entity.

The Court in such matters confronted a critical choice. It could develop bright line, doctrinal rules to define and limit state and national powers, consistent with the Constitution's words and animating spirit. Or, it could look to utilitarian purpose, to develop less a doctrine of federalism as constitutional decentralization and more a balance among competing interests, whose implications would differ from case to case, resulting in a contingent decentralization.

The Court did begin its inquiries into federalism along doctrinal lines. But these soon gave way to a consequentialist jurisprudence. The Court thereby replaced its earliest understanding of federalism as constitutional decentralization with one of federalism as contingent decentralization. The inevitable result of this shift has been the increasing centralization of the American polity, along with the decline of federalism itself.

Confining the Federal Government

The Supreme Court's problem with respect to the federal government is, was, and ever shall remain that of keeping it in its place, so that it does not assume many of the substantive powers that legitimately should remain with the states. The problem emerges in the context of several constitutional provisions. I am less concerned here with those regarding the federative powers of national defense and international relations than with those involving the commerce power. In particular: How might the Court hew out doctrinal constitutional divisions between the national and state governments?

The principal intent of the commerce power doubtless was to limit the states' abilities, through tariffs and other trade restrictions, to wage economic warfare on each other. A secondary intent was to allow Congress to enact such measures as would facilitate commerce, thereby promoting a national common market. But where, and how, would the Supreme Court draw the line on national powers?

Its earliest pronouncement on this subject, *Gibbons v. Ogden* (22 U.S. 1 [1824]), was really a case about state powers. New York had granted an exclusive franchise requiring vessels sailing to and from New Jersey to acquire and pay for the franchisee's permission to sail. A federal law arguably preempted this arrangement. Chief Justice Marshall's opinion for the Court struck down the New York law on preemption grounds. And, not surprisingly, modern commentators read the case as a brief for expansive federal powers (see, e.g., Tribe 1978, p. 232).

Richard Epstein (1987), by contrast, has discovered in the *Gibbons* opinion an important doctrinal distinction. In noting that it was within the power of the states to inspect goods bound for interstate commerce, Marshall wrote that this power is actuated *before* the goods enter the stream of commerce. Inspection laws, Marshall said, "act upon the subject before it becomes an article of foreign commerce, or of commerce among the States, and prepare it for that purpose" (22 U.S. at 203). The implication is that commerce in the contemplation of the commerce clause is a limited matter, and therefore the power of Congress to regulate interstate commerce is likewise restricted to interstate commerce itself, and does not include a power to regulate activities that occur before commerce.

Epstein traces out the rise and decline of this distinction, and with it, I would add, the rise and decline of federalism as constitutional decentralization. The distinction gained its fullest statement in *United States v. E. C. Knight* (156 U.S. 1 [1895]), which overturned a Sherman Act challenge to a merger of refined sugar manufacturers.

Prohibiting the merger, Chief Justice Fuller wrote for the Court, was not within the commerce clause powers of Congress, for the prohibition acted on *manufacture,* not on *commerce.* And "commerce succeeds to manufacture, and is not a part of it" (at 16).

This principled, doctrinal distinction held up in *Hammer v. Dagenhart* (247 U.S. 251 [1918]), but it began to unravel almost immediately thereafter. By the time of *NLRB v. Jones & Laughlin Steel Corp.* (301 U.S. 1 [1937]), Chief Justice Hughes jumped completely over the barrier that *E. C. Knight* had erected, to make the question of congressional power one of economic incidence, and not one of bright line distinctions. "It is the effect upon commerce," he wrote for the Court, and "not the source of the injury, which is the criterion" (at 32).

The complete demise of any boundary whatsoever on the commerce clause powers of Congress came in 1942, with the infamous case of *Wickard v. Filburn* (317 U.S. 111). At issue was the authority of the secretary of agriculture to fine wheat growers who consumed their entire output; that is, to fine those whose wheat never entered commerce at all. The Court found the necessary connection with interstate commerce. The possible economic effect of such wheat on interstate prices doubtless seems clear. But the doctrinal distinctions that underlie constitutional decentralization, unlike those that support contingent decentralization, should not advert to such considerations. For to impose an economic understanding on the issue of judicial line-drawing is to assert that all economic activity is bound together in a seamless web of national and increasingly international dimension. Thus, all economic activity becomes subject to congressional control.

Not surprisingly, therefore, the judicial demise of the manufacture-commerce distinction has allowed Congress to regulate virtually every aspect of enterprise, and even of enterprise confined wholly within a particular state. The commerce clause thus has become the vehicle for a plenipotentiary federal control of all aspects of private economic life, including matters of industrial organization, labor relations, worker and product safety, environmental quality, race relations, and matters involving gender.

Confining the State Governments

The Supreme Court's problems with respect to the states, of course, goes to the essential reasons for the originating allocation of commerce clause powers to the federal government. That is, the language of the Constitution plainly intended to preserve a national common market against state derogation. The Court faces problems in this

matter with respect to two different state activities: regulation and taxation. I consider these separately. Each subject involves exceedingly complex legal and economic questions. But a pattern emerges that parallels in many respects that found in the Court's treatment of congressional powers.

1. *Regulation.* The Court's most fully developed modern statement of its criteria for deciding whether a state regulation that is claimed to burden interstate commerce is or is not constitutionally permissible appears in *Pike v. Bruce Church, Inc.* (397 U.S. 137, 142 [1970]): "Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."

Notwithstanding the Court's frequently announced intention to apply such balancing tests to state regulations claimed to burden interstate commerce, the Court's actual performance in this area takes a wholly different approach. In almost all modern cases, if a state statute *facially discriminates* against interstate commerce, then the Court will strike it down, unless state interests seem especially compelling or the state has an evident essential fitness to regulate.

For example, in *City of Philadelphia v. New Jersey* (437 U.S. 617 [1978]), the Court overturned a New Jersey statute that barred the importation of waste collected in other states. But compelling state interests will overcome such results. In *Maine v. Taylor* (477 U.S. 131 [1986]), for instance, the Court upheld a state law barring imported live baitfish, on the grounds that such bait might infect local gamefish with parasites not native to the state. And essential fitness to regulate comes into play in cases like the classic *Cooley v. Board of Port Wardens* (53 U.S. [12 How.] 299 [1851]), which sustained a state law requiring the use of local pilots for ships entering Philadelphia harbor, or the payment of a fine.

Where facial discrimination is absent, however, the Court almost always will sustain the challenged state regulation, unless federal preemption is present, or the state itself attempts directly or indirectly to regulate national markets. Some of these cases seem especially egregious. *Exxon Corp. v. Governor of Maryland* (437 U.S. 117 [1978]), for example, brought to the Court a challenge to a state law prohibiting petroleum producers and refiners from owning retail outlets. The statute plainly resulted from rent-seeking, entry-restricting moves by Maryland's independent gasoline retailers. But the Court sustained the law on the grounds that it applied equally to in-state and out-of-state producers and refiners. That is, it was not

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facially discriminatory. That there might have been no domestic producers or refiners somehow escaped judicial notice.

The preemption problem emerged in *Edgar v. Mite Corp.* (457 U.S. 624 [1982]). At issue was an Illinois antitakeover statute, which reached beyond corporations chartered in that state, to impose onerous restraints on takeover activity (see, e.g., Jarrell and Bradley 1980; Jarrell 1983). The Court, in a plurality decision, overturned the statute on the grounds that the federal Williams Act preempted it.

Not so the Indiana statute challenged five years later in *CTS Corp. v. Dynamics Corp. of America* (481 U.S. 69 [1987]). There the Court sustained a law more narrowly drawn to get past its earlier holding (see, e.g., Butler 1988; Macey 1988; Fischel 1987; Langevoort 1987). Justice Scalia's concurrence puts the matter baldly: "Nothing in the Constitution says that the protection of entrenched management is any less important a 'putative local benefit' than the protection of entrenched shareholders, and I do not know what qualifies us to make that judgment" (481 U.S. at 95).

To its credit, the Court occasionally will ask if state statutes seek to circumvent national market forces. In *Hunt v. Washington State Apple Advertising Commission* (432 U.S. 333 [1977]), for example, the Court overturned a North Carolina law prohibiting the use of other states' superior agricultural grading methods in place of those developed by the Department of Agriculture. "By prohibiting Washington growers and dealers from marketing apples under their State's grades," said the Court, "the statute has a leveling effect which insidiously operates to the advantage of local apple producers" (at 351).

Brown-Forman Distillers Corp. v. New York State Liquor Authority (476 U.S. 573 [1986]) explored a similar problem. New York law required liquor prices in New York to be no higher than recent prices in other states. The law, said the Court, "regulates out-of-state transactions in violation of the Commerce Clause." It requires "a merchant to seek regulatory approval in one State before undertaking a transaction in another" and, therefore, it "directly regulates interstate commerce" (at 561–62).

2. *Taxation.* The Court's most fully developed modern statement of its criteria for deciding whether a state tax that is claimed to burden interstate commerce is or is not constitutionally permissible appears in *Complete Auto Transit, Inc. v. Brady* (530 U.S. 274 [1977]). The Court there said that it will ask whether the tax "is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State" (at 279).

Not surprisingly, the Court's jurisprudence in this area parallels in many respects that concerning state regulations that arguably burden interstate commerce. Where the tax is facially discriminatory, the Court almost always will strike it down. But where the tax is facially neutral, and notwithstanding the Court's announced intention to perform the balance suggested in *Complete Auto Transit*, the Court almost always will sustain it.

Bacchus Imports, Ltd. v. Dias (104 S.Ct. 3049), for example, brought to the Court a challenge to a Hawaii statute that partly exempted brandies and wines distilled from local produce. The Court overturned the statute on commerce clause grounds. It did likewise in *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue* (483 U.S. 199 [1987]), wherein the challenged statute exempted locally made goods from a manufacturing tax if those goods would be sold in Washington and thus be subject to a wholesale tax. But the Court in *Western & Southwestern Life Ins. Co. v. State Board of Equalization* (451 U.S. 648 [1981]) sustained California's retaliatory tax on insurance premiums against firms domiciled in states whose taxes were greater than California's.

As with state regulations affecting interstate commerce, so with state taxation, and to the same effect: facial neutrality makes a tax an unlikely candidate for Supreme Court disapproval. The most egregious example is Montana's severance levy on coal, sustained in *Commonwealth Edison v. Montana* (453 U.S. 609 [1981]). Following the Arab Oil Embargo of 1973, and the subsequent increased demand for domestic coal as a source of energy for heating and power, Montana increased its severance tax on coal to as much as 30 percent (see, e.g., McLure 1982, Williams 1982).

The proceeds went to a trust fund that provided 20 percent of the state's revenues. Montana accounted for 25 percent of the nation's coal reserves and 50 percent of its reserves of low-sulfur coal. Not surprisingly, debates over the tax increase in the Montana legislature noted that other states would bear most of the burden: Montana acknowledged that nearly all of the tax would be exported, since 90 percent of the coal went to other states. But to no avail: the Court sustained the tax.

Federalism: Reasons and Rules

Our brief exploration into the economic logic of federalism, its various historical meanings, and the political and judicial forces acting upon it, suggest these conclusions. *First*, decentralization as a way to allocate responsibility for governance enjoys patent welfare-

regarding justifications. These include cost-and-benefit responsibilities, economies of scale, and the advantages of interpolity competition. *Second,* contingent decentralization alone cannot protect against informational asymmetries and political forces leading to increased centralization. Therefore, for federalism to survive, the courts must be willing to apply the original understanding of the American arrangement as *constitutional* decentralization. *Third,* the Supreme Court has turned aside from this task, with two inevitable results: the federal government has gained power at the expense of the states and of the welfare of citizens that constitutional decentralization originally contemplated; and paradoxically, the states have gained power over the national common market, with similar unwanted consequences for that market's preservation. It remains for us to close three interlocking circles with respect to these conclusions.

The Reason of Rules

First, if we advert to the utilitarian, welfare-regarding goals and justifications for *any* form of decentralization, our exploration shows that the decentralization that makes the achievement of those goals possible must rely for its existence on ignoring those goals entirely in particular cases. That is, the reason of the doctrinal rules of federalism lies in the paradoxical claim that the decentralization will fail, and therefore the utilitarian consequences of decentralization will disappear, if we invoke those consequences alone in our defenses of decentralization.

The demise of federalism as contingent decentralization, and tautologically the demise of federalism as constitutional decentralization, begins with the meta-decision to choose sides in particular cases solely by considering consequences instead of rules and rights. Balancing tests in place of doctrinal constitutional argument provide the acid that eats away at the girders of federalism, leaving the states not more than *functus officio,* except as they can here and there sequester the ability to erode market forces that the constitutional arrangement so obviously sought to protect. One can do no more, in this respect, than to quote Hayek's (1973, p. 61) famous passage about the defense of freedom, and draw the straightforward analogy about the defense of federalism:

> The preservation of a free system is so difficult precisely because it requires a constant rejection of measures which appear to be required to secure particular results, on no stronger grounds than that they conflict with a general rule, and frequently without our knowing what will be the costs of not observing the rule in the

> particular instance. A successful defense of freedom must therefore be dogmatic and make no concessions to expediency, even where it is not possible to show that, besides the known beneficial effects, some particular harmful result would also follow from its infringement. Freedom will prevail only if it is accepted as a general principle, whose application to particular instances requires no justification.

The Limits of Rules

But are there limits to doctrine? After all, applying such an approach to a jurisprudence of federalism must seem a terrifying prospect. As Justice Jackson noted in a different connection, in his dissent in *Terminiello v. Chicago* (337 U.S. 1, 37 [1949]): "If the Court does not temper its doctrinaire logic with a little practical wisdom, it will convert the constitutional Bill of Rights into a suicide pact." That possibility raises two distinct problems.

First, a doctrinal adherence to federalism as constitutional decentralization actually might subvert the achievement of its particular utilitarian goals. For example, air or water pollution might flow across state lines, and the optimal scale of some government services might exceed the output of particular, and especially smaller states.

I am not greatly concerned about such prospects. The question is *not* whether we should subvert the constitutional guarantees of federalism, to force the states to address such problems or to have the federal government do the job for them. There may be other constitutional grounds for national action. More important, both federalism in general, and the Constitution in particular, embrace the possibility of joint action among sets of states to overcome these problems. Where mutually beneficial gains from joint action are possible, they can emerge voluntarily, as in any market relation.

Surely, the states have not done enough using such tools. In any potential contract, the risk is inevitable that jockeying for position in dividing the surplus of joint action will undermine agreement. But the inadequacy of present interstate cooperation also gives evidence that the tools of agreement have grown rusty precisely because of federal preemption. The quality of states' cooperative actions, therefore, may remain a function of the national government's willingness or unwillingness to stand aside, to allow learning to occur. That course, I believe, holds better prospects than does the present use of national legislation, and even that legislation regarding exactly such questions as pollution control, for mutual plunder (see Ackerman and Hassler 1981).

Second, there may remain a residuum of issues on which people hold intense preferences, and where progress might not occur with-

out a frank overturning of federalism's constitutional predicates. The underlying political logic of such situations is thus. People within or beyond the borders of a particular state want that state's political or judicial branches to take actions that a majority of its citizens or agents do not prefer. But the demanders know that agents located in national political or judicial branches are willing to take such actions. Federalism, however, allocates responsibility for such actions to the states. Federalism thereby protects the preferences of (some of) those within the state, to the detriment of others within or without the state.

The central most important issue that this pattern affects is race. Riker (1964, p. 155), writing over a quarter of a century ago, emphasized both this aspect of federalism and his own results-oriented approach to it:

> If one approves the goals and values of the privileged minority, one should approve the federalism. Thus, if in the United States one approves of Southern white racists, then one should approve of American federalism. If, on the other hand, one disapproves of the values of the privileged minority, one should disapprove of federalism. Thus, if in the United States one disapproves of racism, one should disapprove of federalism.

Riker's consequentialist view leaves us with two alternatives: Enjoy the virtues of federalism along with the vices of institutionalized racism; or, forego the virtues of federalism and achieve the virtues of racial justice. If the choice is as stated, I am no better than is anyone else at deciding, though I am fairly certain that I would forego federalism, with the hope that some aspects of it could be resurrected after justice prevails.

But even in such circumstances, the facts are seldom so clear. First, the citizen's best protection may be the ability to avoid the transgressions of racism by voting with his feet. Foregoing federalism eventually might entail the loss of such protection. Second, the nationalized civil rights revolution allowed state officials perpetually to avoid the responsibility of making hard choices. That, after all, was the implication of congressionally and judicially mandated desegregation orders.

Yet, they might have had to make such choices had they been left to their own devices, and had they been made to face political developments within and without their states. Much of the civil rights revolution, for example, grew out of the dominance in the Senate of Northern liberal Democrats, following the presidential election of 1964 (Aranson 1981, chap. 4). Before that time the Southern states economically had been kept afloat by a stream of federal

spending that relied on the dominance in Congress of Southern Democrats, who held important committee leadership positions by virtue of their seniority. The elections of 1964 jeopardized that pattern of control and expenditures, and the Southern states soon would have had to relent on issues of race, in exchange for continuing federal spending in the region.

We will never know how much better it might have been for peaceful change and for the quality of state leadership had the Southern states instituted their own changes. But the matter deserves some thought, especially because of the loss of a robust federalism that the conflict's national, constitutional resolution ultimately imposed on us.

Nor is it clear that the loss of federalism's protections brought unalloyed benefits in other policy areas. The value of some of these protections we now can acknowledge in hindsight and in light of the present Court's occasional, though meager and ultimately misguided attempts to resurrect the elements of constitutional decentralization.

Federalism can be a neutral sword in its defense of ideological positions *within* states. Certainly, the religious right gained the advantage on the grounds of federalism when the Court upheld Missouri's more restrictive regulation of abortions, in *Webster v. Reproductive Health Services* (109 S.Ct. 3040 [1989]). But the Court in *Bowen v. American Hospital Ass'n* (476 U.S. 610 [1986]) likewise turned aside on grounds of federalism the Reagan administration's attempt to regulate, and ultimately to eliminate, the practice of withholding life-saving medical procedures from impaired newborn children.

Even Governor Michael Dukakis, though ultimately unsuccessful, could advance reasons of federalism in support of his preventing the training of Bay State National Guard personnel in Latin America. The ultimate irony doubtless will occur on the day that Governor Douglas Wilder's attorney general argues before the Supreme Court that the federal government has no business telling the governor of Virginia how to conduct his state's affairs.

The Limits of Reason

The final circle to close reflects the worrisome limits of reason in defending or attacking ancient practices such as constitutional decentralization. We cannot find the ultimate defense of such practices in particular results, for those results accept a static reality, with no possibility for real institutional change. An argument in favor of national action, and against constitutional decentralization, for example, may take this form: Certain questions are sufficiently com-

plex and conflicted that they require a more progressive, sophisticated, responsive, and courageous legislature for their resolution. Concerning such matters, the federal House and Senate are thus to be preferred to their counterparts in the states.

The problem with this claim, aside from its ultimate unbelievability in the light of FSLIC and related scandals, is that the quality of representation is not exogenous to the problems to be resolved. If federalism as constitutional decentralization perishes, and if the states remain only with low-level administrative problems to resolve, then citizens will give state governments little heed. Not surprisingly, far more Americans know the names of their federal senators and representatives than those of their statehouse counterparts. If state government matters little, then elections of state officials will matter less. An improvement in the quality of state governments thus may require state political leaders to engage just those issues with which, by hypothesis, they remain not yet ready to struggle.

This observation brings us full circle to the question with which we began. The Framers' meaning of federalism was constitutional decentralization, and we have traced out how that meaning and its implications have been lost to us. But before the Framers' federalism, the idea of federalism embraced an older concept of covenant, as among sovereigns. Covenant preserved the dignity and worth of each sovereign, and as applied by analogy to the individual human being, it preserved first self-actualization and essential "humanity" and then republican virtue.

But these valuable aspects of human existence did require polities to be small enough to allow meaningful, informed, and efficacious participation in political life. Those adjectives measure goals whose achievement reflects one characteristic above all else: the size of the polity. A vote in a national election shares nothing but symbolic worth. A vote in New Hampshire, or Vermont, or Alaska, by contrast, begins to have some public consequence, however small, beyond the voter's symbolic satisfaction.

Can citizens care about the public consequences of their actions if no such consequences prevail? I believe that that is not more likely than that they can care about (state) legislators whose functions are grossly limited by federalism's demise. Perhaps the devolution of such responsibility to the individual citizen through federalism's reinvigoration will produce no such public-regardedness. The very concept might have been lost forever, along with the notion of republican virtue itself, as a consequence of two centuries of centralization. That is, our contemporaneous reason may have no place for such concepts in calculating the virtues of any measure of decentraliza-

tion. But we shall never know how robust these concepts might be until we put them to the test. Meanwhile, we have Montesquieu's promise that a republic, "if it be large, . . . is ruined by an internal imperfection."

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