

**MADISON WITH A MINUS SIGN:
THE POLITICAL ECONOMY OF “OUR FEDERALISM”**

**Book Abstract
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Introduction: Federalism’s Inversion

Federalism is the *basso continuo* of American politics, and contemporary politics is no exception. From education policy to tort reform, from financial regulation to environmental policy, from gay rights to Medicaid, federalism and “states’ rights” form a salient and sometimes dominant theme of the political debate. That debate principally revolves around the federal “balance” and the role of the states in the federal scheme. The implicit assumption is that federalism and centralization are opposite poles: power either accumulates in Washington or else, “devolves” to the states. That perspective, however, misses the pathologies of contemporary American federalism.

Under our federalism, the federal government may (and often does) regulate the mere possession of marijuana, our children’s grade school curriculum and lemonade stands, and conflicts between your plan to build a home on your property and a toad’s desire to conduct procreative activities in the same location (usually, the toad wins and you lose). Conversely, under our federalism, state attorneys general impose national sales taxes, local judges and juries set national product standards, and state legislatures contrive to regulate and tax internet transactions. In short, we have not one but two

federalism problems. The first, well-known problem is federal overreach and meddling in local affairs that “can never be desirable cares of a general jurisdiction.”¹ The second, poorly understood but increasingly virulent federalism problem is state interference with sister-states’ and national affairs. My shorthand for the concurrent emergence of those problems is “constitutional inversion.”

Federalism presumes that some issues—national defense, interstate relations (including trade)—are best handled at a central, national level, while matters that are local in scale are best left to the states. That intuition reflects a wide range of values and objectives—a desire to make room for political diversity, experimentation and learning; to facilitate political participation and administration closer to the people; or to put governments into competition for a mobile citizenry.² These values are not perfectly congruent, and making the intuitive distinction between national and local affairs work is a demanding intellectual and institutional task. But there has to be *some* such distinction and a corresponding assignment of powers.

The United States Constitution reflects an astute sense of what powers belong where and why. Recognizing that the boundaries are somewhat fluid, contestable, and context-dependent, the Founders wisely refrained from freezing them in elaborate detail. Instead, they sketched the general contours and set out to design an institutional system that would keep the outcomes within reasonable bounds of the constitutional plan. That project, however, has failed. At the outer limits, the original distinctions and assignments still operate. State judges and attorneys general do not (yet) commandeer the 82nd

¹ Alexander Hamilton, John Jay, and James Madison, *The Federalist* No. 17 (Hamilton), ed. George W. Carey and James McClellan (Indianapolis: Liberty Fund, Inc., 2001), 81.

² For a judicious discussion see Michael McConnell, “Federalism: Evaluating the Founders’ Design,” *University of Chicago Law Review* 54 (1987): 1484–1512.

Airborne, and the U.S. Department of Education does not actually run local schools. (It merely hectors their administrators.) Over a vast range of government activities, however, the federal system has been inverted. What once was purely local has become national, and vice versa.

Madison With a Minus Sign—over long stretches, a synthesis of my writings on federalism over the past five-plus years—traces the logic and consequences of federalism’s inversion. In the form of a simple “political economy” story, I interpret the inversion as a shift from the pre-constitutional preferences of individuals to those of surplus-maximizing governmental “Leviathans.” In its original, constitutional version, federalism aimed to maximize benefits for citizens, principally by means of *disciplining* government through institutional competition. In its contemporary form, federalism serves to maximize the benefits of politicians and their interest group clientele, principally by *empowering* government at all levels and by facilitating the creation of intergovernmental policy cartels. The transition point from competitive to empowerment or cartel federalism is the New Deal, whose institutional logic is only now playing itself out.³ That shift occurred through a pattern of institutional collusion against which the constitutional arrangements provided no viable defense.

I will try to show that this model, despite its gross simplicity, better explains the structural features of modern American federalism—in operation, and in legal theory—than any competing model. In particular, it captures the otherwise perplexing renaissance

³ I use the term “New Deal” as shorthand for a constitutional transformation that is, obviously, historically complicated and subject to widely varying interpretations. For a concise overview of the debate among constitutional theorists and historians see G. Edward White, *The Constitution and the New Deal* (Cambridge: Harvard Univ. Press, 2000), 13–32.

of state power. But the theory also has a normative dimension: Unless we can figure out a way to re-invert federalism, we might be better off with a wholly national government.

Inverted federalism has enormous political stability—far more stability than competitive federalism.⁴ Any plausible reform scenario has to assign a prominent role to the federal judiciary. Proponents of such an agenda carry a heavy burden. They must show that institutional competition is a central constitutional value and, moreover, an attractive value. They must repudiate the charge that a jurisprudence based on that value would amount to an anti-democratic judicial coup d’etat—the restoration of a “Constitution in Exile,” to borrow a phrase. On a more pragmatic note, they must show that such a jurisprudence would be politically sustainable. Much of the book is dedicated to these difficult questions.

I. Federalism: Centralization, Adjustment, or Inversion?

Macro-political theories from Tocqueville to Weber have described centralization as the inescapable fate of democratic societies, and the American experience looks like a case in point. The history of American federalism is a history of centralization—the enactment of the Fourteenth Amendment; the ratification of the Seventeenth Amendment providing for the direct election of Senators; the Sixteenth Amendment, authorizing the federal imposition of an income tax; the rise of corporate capitalism, the Progressives’ and New Dealers’ response, and the enormous expansion of congressional powers under the New Deal Court; the federal response (belated, but energetic when it materialized) to

⁴ The historical contingency and instability of competitive federalism structures is explained by a robust body of scholarship. See, e.g., William Riker, *Federalism: Origin, Operation, Significance* (Boston: Little, Brown, 1964).

abhorrent Jim Crow laws and practices; the “incorporation” of the Bill of Rights and its application to the states under the Fourteenth Amendment and, in modern times, the judicial discovery of an ever-broader array of rights that confine the states’ moral choices.

An alternative view describes federalism’s trajectory as a functional adjustment. In response to exogenous social events—universal suffrage, industrial capitalism—federalism did not disappear but rather assumed a different, “cooperative” form. Its new shape is characterized by largely concurrent federal and state responsibilities, cooperation both among states and between the states and the federal government, and an interpenetration of federal and state functions. Federalism equals intergovernmentalism. In a famous metaphor, it is a “marble cake” rather than a “layer cake.”⁵ One version of this view holds that American federalism was cooperative *ab ovo*. A different version holds that the transformation was real—but also inescapable and, in any event, to the good.⁶

In the end, not a lot of daylight separates these accounts. Sophisticated centralization theorists acknowledge that states, under cooperative federalism, continue to play a role in policy formation and implementation.⁷ But they observe that the federal government’s expanded role implies an enlarged measure of central control over the ends

⁵ Morton Grodzins, *The American System: A New View of Government in the United States*, ed. Daniel J. Elazar, (New Brunswick: Transaction Publishers, 1984).

⁶ See, respectively, Daniel J. Elazar, *The American Partnership* (Chicago: Univ. of Chicago Press, 1962); and Roderick M. Hills, Jr., “The Political Economy of Cooperative Federalism: Why State Autonomy Makes Sense and ‘Dual Federalism’ Doesn’t,” *Michigan Law Review* 96 (1998): 813–944.

⁷ James Q. Wilson, The Rise of the Bureaucratic State, in, *The American Commonwealth: 1976*, ed. Irving Kristol and Nathan Glazer (New York: Basic Books, 1976), 91; Aaron Wildavsky, “Fruitcake Federalism or Birthday Cake Federalism,” in *Federalism & Political Culture*, ed. David Schleicher and Brendon Swedlow (New Brunswick: Transaction Publishers, 1998).

of local policy. Relative to a baseline of state competition, cooperative federalism amounts to “centralization with a human face,” as Aaron Wildavsky acerbically called it.⁸ Far from seriously contesting that view, the cooperative federalism literature abounds with complaints that federalism, as actually practiced, leaves insufficient room for state initiative and experimentation.⁹

The political federalism debate of the past decades mirrors the scholarly literature in the acceptance of cooperation rather than competition as federalism’s paradigm; in the consequent restriction of “federalism” to questions of intergovernmental relations; and in the pervasive laments over unnecessary centralization. In politics as in the literature, those laments have been accompanied by recurrent attempts to carve out a more substantial role for the states. In the 1970s, the Nixon administration launched a “New Federalism” initiative. In the 1980s, the Reagan administration pursued a more ambitious effort to disentangle government functions. In the 1990s, we witnessed both “devolution”—a key component of the Republican Party’s 1994 “Contract With America”—and the judicial federalism of the Rehnquist Court, which attempted to rehabilitate constitutional protections for the states. All these initiatives, though, have come to naught. “New Federalism” initiatives never had direct, tangible effects for large numbers of citizens (and arguably lacked the potential of having such effects).

⁸ Aaron Wildavsky, “Federalism Means Inequality,” in *Federalism & Political Culture*, 52. A burgeoning literature on the “migration” of tax authority in federal systems corroborates this assessment. See, e.g., Jonathan A. Rodden, *The Promise and Peril of Federalism: Hamilton’s Paradox* (Cambridge: Cambridge University Press, forthcoming); Timothy Besley and Stephen Coate, “Centralized versus Decentralized Provision of Local Public Goods: A Political Economy Approach,” *Journal of Public Economics* 87, no. 12 (2003):2611–37.

⁹ Scholars have diagnosed a transition from “cooperative” to “coercive” federalism to describe the deterioration of the states’ bargaining power vis-à-vis the federal government. See, e.g., Daniel J. Elazar, et al., eds., *Cooperation and Conflict* (Itasca, Ill.: F.E. Peacock, 1969); John A. Kincaid, “From Cooperative to Coercive Federalism,” *Annals of the American Academy of Political and Social Science* 509 (1990): 139– 152.

“Devolution” yielded the 1996 welfare reform, which provided states with substantially greater flexibility in administering federal welfare programs. That law, however, has remained an exception to a general trend of continued centralization, most notable in education policy. The Rehnquist Court’s federalism has fizzled and, even at its zenith, held interest mostly for legal specialists, rather than ordinary citizens.

Administrative centralization, moreover, has been accompanied by a progressive legal centralization of basic social choices, from abortion to drug policy to homosexual rights. Scholars, journalists, and some political activists have attempted to make a case for a “moral federalism” as a sensible, tolerant way of tackling seemingly intractable disagreements over questions of public morals.¹⁰ But these lonely voices are drowning in judicial intransigence and interest group insistence on “rights”—in other words, on uniform baselines that obviate genuine state choice and experimentation. Federalism appears to have imploded.¹¹

And yet: over the past two decades, the states have celebrated a revival in a different arena—the regulation of business firms and economic transactions. State initiatives in this arena are the stuff of daily front-page news coverage. In 1998, states concluded a comprehensive settlement with leading tobacco manufacturers, which imposed a national tax of some \$246 billion and, moreover, a detailed regulatory scheme governing the sale and marketing of cigarettes. Shortly thereafter, states pursued an antitrust proceeding against Microsoft, in which they continued to demand the company’s

¹⁰ See, for example, Alan Wolfe, *One Nation, After All: What Middle-Class Americans Really Think About God, Country, Family, Racism, Welfare, Immigration, Homosexuality, Work, The Right, The Left and Each Other* (New York: Viking Books, 1998).

¹¹ Robert Nagel, *The Implosion of American Federalism* (New York: Oxford University Press, 2001).

dismemberment even after the federal government had decided to settle the matter for less intrusive remedies. After the 2000 stock market collapse, states played a lead role in creating new national regulatory regimes for brokerage houses, mutual funds, and insurance brokers. States have launched ambitious attempts to regulate pharmaceutical prices and to facilitate the re-importation of drugs from Canada, in defiance of federal law. These headline-grabbling interventions are the proverbial tip of the iceberg—a great mass of state regulation of internet transactions, mortgage lending, products liability, insurance, advertising, product labeling, and much else besides. Never before in American history have the states wielded comparable power over the commerce of the United States.

The states' resurgence in this arena is unexpected—and unexplained. In light of a pronounced division into “blue” and “red” states, one might expect an increased insistence on state prerogatives over social issues. There is some evidence to that effect, such as state constitutional amendments aimed at forestalling same-sex marriages. But these measures merely serve to stem further losses of state autonomy, not to regain lost ground. One might likewise expect more assertive state demands for greater autonomy in the core areas of cooperative federalism—that is, federally funded service programs, from education to Medicaid. Those demands are a staple of the political debate but, as noted, have produced no clear gain for the states. Instead, the states have staged their comeback in regulating the nation's commerce. That development is perplexing in a historical perspective: the inherently national (and now global) character of capitalist production was the central argument for augmenting the national government's powers. It is perplexing from a functional perspective: among all the explanations of why

centralization happens (and ought to happen), the need to organize commerce on a political level commensurate to its scale ranks second only to mass democracy. It is perplexing from a constitutional perspective: among the Founders' arguments for the union, the need to protect interstate commerce ranked second only to national defense. Even as a matter of common sense, our so-called federalism seems perplexing. No one in his right mind would put the national government in charge of local crime or, conversely, commit national industries to the tender mercies of local juries.¹² Why do we?

Journalists have noted an obvious difference between states' rights, once and now: in contrast to the conservative federalism initiatives of decades past (not to mention "states' rights" resistance against federal civil rights laws), the contemporary push for states' rights is a liberal phenomenon.¹³ Its protagonists are state attorneys general, trial lawyers, and consumer and environmental groups. Behind that perceived irony, though, lie deeper differences. First, the states' resurgence is not an outgrowth of a national initiative to return power to the states, to protect their constitutional role, or to engineer a "devolution" of governmental functions. It is rather the product of an authentic and insistent demand for a more prominent role, which the states have pressed in the face of vehement resistance by powerful interest groups (prominently, business) and, sometimes, national political institutions. Second, the new states' rights movement is muscular,

¹² Public statements that routinely accompany the political use of "inverted powers" buttress this view of the matter, albeit obliquely. The most aggressive practitioners of the newest federalism—for example, New York Attorney General Eliot Spitzer—disavow the notion that their interventions are a sensible allocation of powers. Rather, they argue, the genius of federalism is to allow for *ad hoc* state responses when the federal government falls down on the job. It would be best for all concerned if federal attentiveness obviated the need for state improvisation. Conversely, federal interventions into local drug regulation or family law are typically accompanied by protestations of utmost urgency, such as the "war on drugs" or the need to ensure the human right to define the meaning of life. Short of those exigencies, the implicit concession runs, a more decentralized assignment of government powers ought to prevail. Such disclaimers buttress the inversion metaphor in two ways—because they acknowledge the normative force of traditional, constitutional assignments of powers in theory, and because they deny it in practice.

¹³ See, e.g., Alan Ehrenhalt, "States' Not-So-Dire Straits," *Governing* March 2005, 6-7.

robust, and of enormous and direct consequence. It affects millions of shareholders, taxpayers, mutual fund customers, smokers, patients and insurers, workers and employers, homeowners and mortgage lenders. Third, and again in contrast to “New Federalism” initiatives, devolution, and the Rehnquist Court’s judicial federalism, the newest federalism has staying power. It will in fact extend its reach. No political force exists to arrest it, let alone reverse it.

On a charitable view, the states’ re-emergence may signal the genius of America’s constitutional system and the health of her political institutions. In periods of activist national government—as between the 1930s and the 1970s—the states naturally play a subordinate role. The constitutional system, however, ensures that Washington, D.C. cannot altogether overwhelm the states. Thus, Richard Nathan suggested in an elegant 1990 essay,¹⁴ states remain capable of reasserting themselves in periods of federal retrenchment, conservatism, or gridlock. In the 1880s and 1920s, Progressive state experiments laid the groundwork for what later became national labor and welfare legislation. In the 1980s, states responded to federal funding cutbacks by substituting their own financial resources or regulatory regimes. Allowing for periodic swings this way or that, the system returns to an equilibrium—a federalism balance. This view rightly suggests that the story of federalism as a victim of progressive centralization is not fully persuasive. But it is misleading in other, crucial respects.

State and national power have expanded, and continue to expand, in each other’s domains—and, moreover, *exclusively* in those domains. The states’ new “federalism” operates exclusively in the sphere of national economic transactions, and will continue to

¹⁴ Richard P. Nathan, “Federalism—The Great ‘Composition,’” in *The New American Political System*, ed. Anthony King (DC: AEI Press, 1990), 231–262.

remain so limited. It has juxtaposed itself to emphatically nationalist arrangements on morals regulation and the provision of social services, which will likewise remain in place. To view this as a “balance” (a metaphor wisely eschewed by Nathan, but a staple of high-toned Supreme Court decisions and political rhetoric) is to treat “power” as an undifferentiated mass. That is absurd. Suppose the federal government and the states “swapped” control over the armed forces and land use planning. And suppose this were done in a way that implies no change on the vectors on which we measure power, such as government budgets or employment: would we seriously call the post-exchange state of affairs an “equilibrium” or “balance”? The obvious answer demonstrates that federalism involves the assignment of incommensurate powers (in the plural) to different levels of government, not a cut through a glob.¹⁵

The “balance” metaphor falsely suggests, moreover, that the distribution of power between the national government and the states is a zero-sum game. But a balance can be maintained by expanding or contracting power at both levels simultaneously. Once lost, balance can be restored by expanding or contracting power at one or the other level. None of these moves necessitates a transfer of power from one level to the other. Currently, state power over the national economy *and* national power over local affairs continue to expand, both on the wrong margins. That is an inversion, not a balance.

II. Constitutional Premises and Modern Federalism Theory

¹⁵ The example highlights the difference between earlier periods of state re-assertion and this one. The historical examples discussed by Nathan all involve a reassertion of state initiative with respect to the states’ internal governance and affairs. The newest “federalism” does not.

What explains federalism's inversion? A historical account might run as follows: contrary to lore, the New Deal was never really a centralizing or nationalist revolution. Rather, the New Deal unleashed government power at all levels (state as well as federal), and it liberated the states on precisely the margin where they have lately staged their seemingly unlikely comeback—the regulation of interstate economic transactions.¹⁶ For several decades, the states failed to avail themselves of those powers, for contingent though potent historical reasons. In the 1940s and 1950s, World War II and the Cold War naturally directed attention to Washington, D.C. In the 1960s, the shameful resistance to civil rights laws discredited the states across the board. In the 1970s, a flood of federal legislation again consigned the states to a minor role. Beginning in the 1980s, however, the advent of the Reagan administration, the collapse of the New Deal coalition, and decades of divided government in Washington induced a migration of regulatory demands to the states, which promptly picked up the slack.

While that story strikes me as roughly right, my principal interest lies not in the efficient or proximate causes of the New Deal transformation and its historical trajectory but in the inherent logic of the underlying federalism models and of the transition from one to the other. I approach that question from the perspective of “constitutional political economy,” a branch of public choice theory that counts William Riker, James Buchanan, and (in a more eclectic mode) Robert D. Cooter among its most prominent proponents.¹⁷

¹⁶ For an instructive account of this widely misunderstood aspect of the New Deal see Stephen Gardbaum, “New Deal Constitutionalism and the Unshackling of the States,” *University of Chicago Law Review* 64 (1997): 483–566.

¹⁷ See, e.g., William Riker, *Liberalism Against Populism* (San Francisco: W.H. Freeman & Co., 1982); James Buchanan, *Constitutional Economics* (Oxford: Blackwell, 1991); Robert D. Cooter, *The Strategic Constitution* (New Haven: Princeton Univ. Press, 2000). For an overview of the literature, see Stefan Voigt, “Positive Constitutional Economics,” *Public Choice* 90 (1997): 11–53. Applications to questions of constitutional change include W.M. Crain and Robert Tollison, “Constitutional Change in an

The simplest political economy models start with the unsentimental assumption that government at all levels will behave as a “Leviathan” that seeks to maximize its surplus—that is, the difference between tax revenues and the costs of public services that its citizens or subjects demand.¹⁸ A rational individual in a pre-constitutional “state of nature,” who harbors Leviathan assumptions but knows little else about his future place in society, will opt for constitutional rules that promise to minimize Leviathan’s surplus without, at the same time, precluding the provision of desired public goods. In a federalism perspective, that choice points to a highly decentralized arrangement that compels states to compete for mobile citizens and their assets, while enabling the central government to procure public goods that cannot be provided by junior governments. In other words, rational (and mobile) citizens will want to mobilize the power of exit and competition to discipline Leviathan. Work through the basic model, and the rational constitutional choice rules prove by and large congruent with “competitive federalism” models that have been developed in a broad range of economically inspired intellectual traditions, from Hayek to Tiebout.¹⁹

Interest Group Perspective,” *Journal of Legal Studies* 8 (1979): 165–75; and Stefan Voigt, “Bargaining for Constitutional Change: Towards an Economic Theory of Constitutional Change,” Diskussionsbeitrag 02-1997, Max Planck Institute for Research into Economic Systems.

¹⁸ Geoffrey Brennan and James Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution*, The Collected Works of James M. Buchanan, vol. 9 (Indianapolis: Liberty Fund, Inc., 1982).

¹⁹ The *fons et origo* of Hayekian theories of federalism is Friedrich Hayek, “The Economic Conditions of Interstate Federalism,” reprinted in F. Hayek, *Individualism and the Economic Order* (Chicago: Univ. of Chicago Press, 1948). The “Tiebout effect,” subject of a literary tsunami, is named after Charles Tiebout, “A Pure Theory of Local Expenditure,” *Journal of Political Economy* 64, no. 5 (1956): 416–424. For a level-headed assessment of the merits and limits of this literature see William W. Bratton and Joseph A. McCahery, “The New Economics of Jurisdictional Competition: Devolutionary Federalism in a Second-Best World,” *Georgetown Law Journal* 86 (1997): 201–78.

Political economy models differ sharply from conventional economic models. Technically efficient rules (in the sense in which economists use that term) will in a political context often yield paradoxical results. For that reason, political economists insist that institutional design questions ought to precede the study of technically efficient rules. A good introduction to the conventional view of tax assignments in federal systems is Wallace Oates, *Fiscal Federalism* (New York: Harcourt Brace

Now invert the perspective: commit the choice of constitutional rules to *Leviathan(s)*, rather than a pre-constitutional individual. Naturally, the Leviathans would choose the rules that promise to maximize their surplus. Lo, it turns out that those rules are largely congruent with “our” federalism. Under competitive conditions, states will behave like private firms in economic markets: they will seek to organize cartels. To that end, states (again, like firms) will often require the assistance of a central, coercive agency—in their case, the central government.²⁰ The central government will in turn accommodate those demands for the same reasons, and in the same way, in which the Federal Communications Commission accommodates the cartelization demands of private broadcasters: the move extends federal authority into an area that would otherwise be beyond reach. If governors got together under conditions of ignorance with respect to their position in the federal scheme of things—knowing that they will be governors, but ignorant about the level at which they will operate—they would agree on cartel-maximizing rules.²¹

The pre-constitutional individual will want to guard against the contingency and place a high premium on constitutional stability. The solution to *that* problem is not a one-shot constitutional contract, which would pose insuperable problems with respect to its enforceability. (Who shall enforce the rules that define the enforcer’s role and

Jovanovich, 1972). For the institutionalist critique of that view see Brennan and Buchanan, *The Power to Tax*, 225. An ingenious version of their argument has been proffered by Gary Becker and Casey Mulligan, “Deadweight Costs and the Size of Government,” *Journal of Law and Economics*, 46, no. 2 (2003): 293–340.

²⁰ Albert Breton, “The Existence and Stability of Interjurisdictional Competition,” in Daphne A. Kenyon & John Kincaid, eds., *Competition Among States and Local Governments: Efficiency and Equity in American Federalism* (DC: Urban Inst. Press, 1991), 49.

²¹ Consistent with the simplifying assumptions of Leviathan theory, I here treat governments as unitary actors. A more realistic interest group perspective actually strengthens the argument.

obligations? The regress is infinite.) The answer, rather, is to structure the constitution in the form of a coordination game that ensures, so far as possible, that the outcomes remain within tolerable bounds of the original rules and assignments. In game theoretic parlance, the objective is to create multiple actors and to block institutional moves to a different set of rules—that is to say, to preclude joint defections from the constitutional norms.²² In the Founders’ language: a constitution is a “mere demarkation [sic] on parchment” unless ambition can be made to counteract ambition. Rival institutions must be given the means and the motives to resist one another.²³

For all its ingenuity, the solution is not failsafe. Lock players into a repeat game, and let them play it often enough: on almost any set of assumptions, they will eventually figure out a cooperative solution.²⁴ For Leviathans operating under a system that minimizes their surplus, the perennial challenge is to figure out a Pareto-superior exit—that is, a cooperative solution that leaves at least some institutional players better off, and none worse. Their best move is to agree to cooperate in the first instance and to haggle over the distribution of the proceeds later on.

That unprovided-for case of joint defection from the constitutional rules is the New Deal. Under the pressure of an exogenous shock (the Depression) and conditions of unusually high political consensus (the landslide election of 1936), political institutions

²² On the theory of a constitution as a coordination game see Peter C. Ordeshook, “Constitutional Stability,” *Constitutional Political Economy* 3 (1992): 137–175. An alternative view in the political economy literature construes constitutions as incomplete contracts that are rendered stable through mutual precommitments and bonding. These rival accounts are complementary in most respects.

²³ *The Federalist* No. 48 (Madison), 260 (“mere demarkation”); No. 73 (Hamilton), 380.

²⁴ Game theorists call this well-established proposition the “folk theorem,” because nobody seems to have discovered it first. See Drew Fudenberg and Eric Maskin, “The Folk Theorem in Repeated Games with Discounting or with Incomplete Information,” *Econometrica* 54 (1986): 533–54.

found a way to shift from conflict to collusion, from competition to cartelization. Political economy models imply that legal rules alone will prove inadequate in arresting joint defections.²⁵ Consistent with that prediction, the Supreme Court first abandoned the competitive baseline rules and then proceeded to generate rules that are consistent with, and conducive to, maximizing the governmental joint surplus.

That's my story. Its simplicity only thinly disguises a number of debatable assumptions and propositions. I contend that modern, economically inspired federalism theory (1) maps the presumptions and logic of the original Constitution; (2) provides a plausible interpretation of the New Deal transformation or (as I prefer to say) inversion; (3) explains, better than any rival theory, the principal features of contemporary American federalism; and (4) provides, for normative purposes, a sound basis for a sensible constitutional jurisprudence. The central and in many ways most problematic claim is the first: if it is unsustainable, the rest of the project falls with it. To what extent, then, is a constitutional choice model congruent with the logic of *America's* constitutional choice (and inversion)?

The claim that modern political economy models converge on Madisonian theory is not novel. The first, diffident suggestion to that effect appeared in James Buchanan's

²⁵ See, e.g., Jenna Bednar, William N. Eskridge, Jr., & John Ferejohn, "A Political Theory of Federalism," in, *Constitutional Culture and Democratic Rule* (John Ferejohn, Jack N. Rakove, & Jonathan Riley, eds.) (Cambridge University Press, 2001): 223-267. To be sure, one need not be a political economist to conclude that the Supreme Court cannot sustain constitutional doctrines against the will of the country's political elites. See Robert McCloskey, *The American Supreme Court*, 4th ed. (Chicago: Univ. of Chicago Press, 2005); and Martin Shapiro, "The Supreme Court from Early Burger to Early Rehnquist," in *New American Political System*.

and Gordon Tullock's *Calculus of Consent* (1962).²⁶ Scholars since have sought to explore or to reassure themselves of the Madisonian roots of the modern theories, and there are some clever and productive applications.²⁷ The most fully developed political economy models of competitive federalism bear resemblance to the United States Constitution.²⁸ But there are also important discontinuities between the modern theories and the Framers' constitutional universe.

Modern federalism theory draws on a range of intellectual traditions. Hayek's account of the "knowledge problem"—the impossibility of acquiring and processing the information that would be required for planned, centralized political management—has inspired federalism theories that emphasize its virtues of decentralization, experimentation, and institutional learning. Economists have developed sophisticated models to show that under well-specified conditions, jurisdictional competition—the so-called "Tiebout effect"—will yield an efficient equilibrium. One and all, though, the models revolve around horizontal competition among governments. The principal theme is to mimic in politics the dynamics of private, competitive markets. Exit is the principal means of constraining Leviathan.

Of all this, not one word can be found in the constitutional debates. Publius discussed state competition only in the form of destructive competition (such as trade

²⁶ James M. Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (Indianapolis: Liberty Fund Inc., 2004), 24.

²⁷ See, e.g., Frank Easterbrook, "The State of Madison's Vision of the State: A Public Choice Perspective," *Harvard Law Review* 107 (1994): 1328–1347. For general discussions of the congruity between Madisonian and Public Choice theory see James Dorn, "Public Choice and the Constitution," in James D. Gwartney and Richard E. Wagner, eds., *Public Choice and Constitutional Economics* (Greenwich: JAI Press, 1988), 57; and Thomas Schwartz, "Publius and Public Choice," in *The Federalist Papers and the New Institutionalism*, Bernard Grofman ed., (New York: Agathon Press, 1989) .

²⁸ See, e.g., Barry R. Weingast, "The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development," *Journal of Law, Economics, and Organization* 11 (1995): 1–31.

barriers and retaliation), which is the opposite of what the modern theorists have in mind.²⁹ The Founders also anticipated that the federal and state governments would compete for citizens’ “affections.” But that dynamic is “competitive” only in a metaphorical sense (it operates without the possibility of exit) and, in any event, has long ceased.³⁰ Even the ancillary virtues of competitive federalism—diversity, innovation, state experimentation and institutional learning—go entirely unmentioned in the *Federalist Papers* and, more broadly, the constitutional debate of the Founding Era.

To some extent, the historical context explains the silence. Civic mobility was at the time much more limited than it is now. The Founders knew that people would move in response to economic deprivation and religious repression, but they hardly envisioned a universal shopping spree for better government.³¹ Too, the authors of the *Federalist Papers* were unlikely to emphasize the virtues of retaining states as (quasi-) autonomous entities, since their entire project was to compromise that autonomy. The Antifederalists, for their part, were equally unlikely to stress the virtues of state competition, which requires for its protection a more powerful national government than the Antifederalists were prepared to tolerate. In some sense, then, competitive federalism may have gone unmentioned because it had no constituency. Still, it will not do to pronounce that competitive federalism is what James Madison had in mind: he didn’t.

²⁹ *The Federalist* No. 6 (Hamilton), 21.

³⁰ It is alive and well in the form of vertical “competition” for the affection of interest groups, whose demands can migrate to the most favorable (federal or state) institution. But this form of “competition” without exit or veto points is not what competitive federalism theory or for that matter the Framers had in mind.

³¹ Alexander Hamilton—in this respect as in many others, the most modern among the Founders—anticipated that marginal tax rates might induce migration, but he did not necessarily relish the prospect. Rather, he feared that the lack of government and therefore taxation in the Western areas might induce the flight of productive labor from the taxing colonies.

That candid admission may seem fateful to a project that revolves, both with respect to its explanatory purpose and its normative plausibility, around the transition from a constitutional, “competitive” federalism to an inverted “cartel” federalism. But this is not really so. The claim is not that James Madison was an early-day James Buchanan. The claim, rather, is that *modern theories of constitutional choice and competitive federalism have improved our understanding of the constitutional structure and logic, in ways that are fully congruent with the original presumptions*. Three fundamental points of agreement emerge between the original, Madisonian framework and the political economy perspective: the pre-constitutional and individualistic perspective; confidence in private orderings and a corresponding fear of interest group politics; and a preoccupation with institutional rules and, in particular, questions of constitutional stability.³²

Constitutional Choice. At first impression, the construct of a pre-constitutional individual seems worlds removed from our historical constitutional choice. The drafting of the Constitution was a series of political compromises, and no “veil of ignorance” clouded the choices. (For example, everyone knew which states were big and which were small.) The document was submitted for ratification to voters and state conventions whose members were very much aware of their particular and often parochial interests, and the authors of the *Federalist Papers* were attuned to that political. Publius candidly

³² “Madisonian” is a term of convenience. I do not mean the true and full views of the actual, historical James Madison on constitutionalism and federalism (which, in my judgment, changed substantially over time). Rather, I mean to reconstruct *one* important train of thought and argument in *The Federalist Papers* and to explore its logic and congruence with modern theory. I prefer “Madisonian” to “Publian” (or something of the sort) because the theory of faction and government that lies at the heart of the matter is distinctly Madison’s.

identified unpersuadable constituencies (state politicians) and, with equal candor, appealed to constituencies who would particularly profit from the Constitution (merchants and investors, who by virtue of their trades were capable of thinking on a continental scale). And in making his pitch to the undecided, Publius appealed to honor and respectability, as well as the lessons of experience, more often than to the dictates of cold reason. Behind these differences, however, lies a fundamental agreement on the notion that one ought to think about government from the perspective of individuals who are capable of looking beyond their own immediate, parochial concerns. The *Federalist Papers* provide powerful testimony to that effect. As it happens, that evidence speaks directly to federalism and its inversion.

Madison's *Federalist* No. 45 marks a pivotal point where Publius transitions from one demonstration ("The necessity of a government at least equally energetic with the one proposed") to another ("The conformity of the proposed constitution to the true principles of republican government").³³ Before moving on to the new subject, Madison takes a last stab at discrediting the most stubborn Antifederalist objections to the preceding demonstration, and he does so in an uncharacteristically impassioned tone.³⁴ "The adversaries to the plan of the Convention," he begins, "have exhausted themselves in a secondary inquiry into the possible consequences of the proposed degree of power [in the federal government] to the governments of the particular states." The dismissive "secondary" begs the crucial question, or rather hides the crucial premise. In the formative period of political unions, a concern over the powers and integrity of future

³³ The formulation of these topics appears in *The Federalist* No. 1 (Hamilton), 4 (italics omitted).

³⁴ Madison rarely resorted to Jeffersonian bombast, both because it was out of character for him and probably because he suspected that he wasn't very good at it. Lance Banning, *The Sacred Fire of Liberty: James Madison and the Founding of the Federal Republic* 233 (Ithaca: Cornell Univ. Press, 1995).

member-states is quite natural—as when we ask whether European integration will serve Germany or Britain, as distinct from individual constituencies within those countries or for that matter European citizens (assuming they exist). Similarly, the product of the Philadelphia Convention embodied compromises among delegates from distinct, separate states. From that vantage, it was not obviously absurd or even “secondary” to worry about the likely consequences of the scheme for states in their political capacity. Madison inveighs against this line of argument by denying its premise:

[If] the union be essential to the happiness of the people of America, is it not preposterous, to urge as an objection to a government, without which the objects of the union cannot be attained, that such a government may derogate from the importance of the governments of the individual states? Was then the American revolution effected, was the American confederacy formed, was the precious blood of thousands spilt, and the hard earned substance of millions lavished, not that the people of America should enjoy peace, liberty, and safety; but that the governments of the individual states, that particular municipal establishments, might enjoy a certain extent of power, and be arrayed with certain dignities and attributes of sovereignty?

Without missing a beat, Madison moves on to a third rhetorical question, now accusing Patrick Henry and his cohorts of closet royalism:

We have heard of the impious doctrine in the old world, that the people were made for kings, not kings for the people. Is the same doctrine to be revived in the new, in another shape, that the solid happiness of the people is to be sacrificed to the views of political institutions of a different form?

He responds in the affirmative:

It is too early for politicians to presume on our forgetting that the public good, the real welfare of the great body of the people, is the supreme object to be pursued; and that no form of government whatever, has any other value, than as may be fitted for the attainment of this object.

“The happiness of the people of America,” “the real welfare of the great body of the people,” is the basic criterion of sensible constitutional arrangements. On that premise and *only* that premise, the Antifederalists’ concerns over the likely effects of the union on state powers are indeed “secondary.” Those concerns look far more pressing, and in fact very plausible, if one inverts the perspective and makes the interests of the states and their political institutions the principal federalism criterion. But to invert the Madisonian premise is to invert constitutional federalism.

Leviathan, Interests, and Faction. Just as it seems far-fetched at first sight to analogize the fiction of a pre-constitutional individual with the Founders’ constitutional perspective, so it seems odd to insist on congruence between “Leviathan” and the Founders’ republican precepts. Here as there, though, the first impression is misleading.

Leviathan’s essential power is the power to tax—in other words, to force exchanges. Unlike the great mass of private, voluntary exchanges (which produce gains from trade), forced exchanges leave somebody worse off. There is, however, some set of desirable public goods that cannot be efficiently procured by means of voluntary exchanges, and so a rational individual will endow Leviathan with the power to procure those goods (at some level) through coercive means. Once granted, that power is subject to abuse. The task, then, is to craft constitutional rules that will permit efficient forced exchanges, while barring such exchanges beyond that point. One of the crucial means of doing so is to limit Leviathan’s surplus.

A pure autocrat will devote the surplus to castles, concubines, and conquests.³⁵ Elected politicians, in contrast, must compete for the spoils, principally by bestowing benefits upon electoral constituencies and interest groups. This theme—the demands of interests groups for a share of the distributable surplus—connects the moderns to Madison’s theory of an extended republic in *Federalist* No.10. Within the states, Madison argued, citizens will be at the mercy of “factions”—that is, “a number of citizens, whether amounting to a majority or minority of the whole, who are united and actuated by some common impulse of passion, or of interest, adverse to the rights of other citizens, or to the permanent and aggregate interests of the community.”³⁶ Small republics will tend to feature a small number of factions, over a narrow range, which will easily “concert and execute their plans of oppression.” Extend the sphere: you extend the range and number of interests, thus heightening the difficulty of achieving agreement. High transaction costs ruin a good day for the legislators and their clientele, while correspondingly protecting “the rights of other citizens.”

This high school-level sketch glosses over major difficulties both with respect to Madison’s theory and its congruence with modern theories that revolve around constitutional federalism constraints. Competitive federalism theory holds that exit and mobility will constrain factional politics at the state level. That in turn presupposes real limits on the national government’s powers, lest Leviathan monopolize the system on all margins. *Federalist* No.10, in contrast, makes only a passing (and unpersuasive) mention

³⁵ Leviathan theory reduces government to a single actor. But that premise serves solely to simplify the analysis; nothing of substance hangs on it. Under either autocratic or republican assumptions, Leviathan will seek to maximize its surplus; the difference lies merely in its dissipation. Brennan and Buchanan, *The Power to Tax*, 36–37.

³⁶ *The Federalist* No. 10 (Madison), 43.

of federalism. In fact, on the theory there propounded, it is hard to see why states—those “wretched nurseries of unceasing discord,” as Publius calls them elsewhere—should be left with any autonomy at all.³⁷

Federalist No. 51 strikes a more state-friendly tone. No amount of interpretive ingenuity, however, gets around the fact that neither Madison nor any other Founder contemplated exit and mobility as a means of constraining factional politics at the state level.³⁸ The correct argument, to my mind, is that that mechanism is (a) built into the constitutional structure and (b) fully consonant with the overriding constitutional task and objective: to design a government that can procure public goods without throwing the door wide open to factional strife and exploitation. That demonstration cannot be performed at the level of abstract argument; one has to work through the Constitution.

Constitutional Stability. The congruence between the modern idea of a constitution as a coordination game and the Founders’ project of arming rival institutions with the means and the motives to resist each other’s transgressions emerges in sharper relief against the alternative, pluralist view of the world. Pluralists view political stability not as a question of constitutionalism but of interest group constellations.³⁹ To their minds, the genius of *Federalist* No. 10 is to have figured that out: so long as there are no

³⁷ The colorful phrase appears in *Federalist Papers* No. 9 (Hamilton), 39, in a passage that predicts the likely fate of the American states if the plan for the union should be defeated. On the tension between *Federalist* No. 10 and federalism see the excellent discussion by David Epstein, *The Political Theory of the Federalist* pp (Chicago: Univ. of Chicago Press, 1984).

³⁸ To my mind, this helps to explain—in a functional, not a historical sense—the breathtakingly “nationalist” means of suppressing factions within the states which Madison urged unsuccessfully at the Convention (prominently, a national “negative” over any and all state laws).

³⁹ The *locus classicus* is Robert Dahl, *A Preface to Democratic Theory* (Chicago: Univ. of Chicago Press, 1956).

permanent majorities or minorities, and so long as “cross-cutting cleavages” generate different majority constellations on different issues, the system will remain stable. Today’s winners have to figure that they might be tomorrow’s losers, and that calculation will temper the urge to oppress and exploit. If some interests manage to entrench themselves, the appropriate response is to make government more democratic, more open to participation by a broader range of interests. Constitutional rules per se yield no stability; they “are mainly significant because they help to determine what particular groups are to be given advantages or handicaps in the political struggle.”⁴⁰

Political economists, in contrast, rely not on the array of interests but on the institutional system in which they are forced to play. Interest group politics is inherently unstable; it invites strife and, eventually, demagoguery.⁴¹ So the politics has to be channeled and restrained. That is what constitutional rules and institutions do, provided one can insulate them from the social instability that they are supposed to contain. In a word (or two), institutions matter.⁴²

Whatever pluralism’s merits, it simply does not wash as a theory of American constitutionalism. The *Federalist Papers*, though hardly oblivious to interest group sociology, are preoccupied with questions of institutional design, the better to provide a

⁴⁰ Ibid., 134. The constitutional version of this theory is *United States v. Carolene Products*, 304 U.S. 144, 152 n.4 (1938): let economic interests roam, but promote democracy by protecting the First Amendment rights of the oppressed and by ensuring protection for “discrete and insular minorities.”

⁴¹ The apprehension is clearest in the work of William H. Riker. See especially, Riker, *Liberalism Against Populism: A Confrontation Between the Theory of Democracy and the Theory of Social Choice* (San Francisco: W.H. Freeman & Co., 1982).

⁴² The difference in perspective has methodological consequences—on the pluralist side, a pronounced tendency to reduce institutional dynamics to a governmental “process”; on the political economy side, a preoccupation with the rules of the game and with nuances of institutional design (and, one must acknowledge, a concomitant tendency to view the rich array of collective social action through the single prism of rent-seeking coalitions).

remedy for faction-driven instability—“that inconstancy and mutability in the laws, which form the greatest blemish in the character and genius of our governments.”⁴³ And even on the most superficial reading, the United States Constitution frustrates democratic ambitions at every turn. Thus, the pluralist reading of *Federalist* No. 10 must be sustained against the rest of the *Federalist Papers* and, at the end of the day, against the text and structure of the Constitution.⁴⁴ Political economy involves no such forced interpretation and striking conclusion. In its preoccupation with institutional detail and its emphasis on constitutionalism as a mainspring of political stability, it tracks Madisonian premises.

III. Constitutional Inversion

Madisonian premises—the *ex ante* perspective, the suspicion of factional politics, the attempt to ensure constitutional stability by means of institutional rivalry—yield a constitutional framework that closely resembles the postulates of what we now call “competitive federalism.” The New Deal inverted all three presumptions and, along with them, the constitutional order.

⁴³ *The Federalist* No. 73 (Hamilton), 381. Madison viewed factional politics as a cause of political instability and as one of its most baneful effects:

Another effect of public instability, is the unreasonable advantage it gives to the sagacious, the enterprising, and the monied few, over the industrious and uninformed mass of the people. Every new regulation concerning commerce or revenue, or in any manner affecting the value of the different species of property, presents a new harvest to those who watch the change, and can trace its consequences; a harvest, reared not by themselves, but by the toils and cares of the great body of their fellow citizens.”

The Federalist No. 62 (Madison), 63.

⁴⁴ Robert Dahl, the most prominent and influential avatar of a pluralist Madison, has of late arrived at that insight—and concluded that he does not have much use for the Constitution. See Robert Dahl, *How Democratic is the American Constitution?*, 2nd ed. (New Haven: Yale Univ. Press, 2003).

The Constitution embodies competitive dynamics at a structural level and at the level of individual provisions. The logic of enumerated (and limited) federal powers, fortified through “checks and balances” and the separation of powers, forces states to play to their competitive and comparative advantages over the range of transactions that are beyond federal reach. The constitutional assignment of specific powers and disabilities reflects the same orientation. The commerce power enables the national government to protect open borders against state protectionism. (That, at least, is its core purpose.)⁴⁵ The powers to regulate bankruptcy and patents are lodged where modern theorists would lodge them—in the national government. Conversely, the Constitution precludes state powers that pose a particularly high risk of interstate exploitation, such as tonnage duties and laws impairing the obligation of contract. Trace the political economy of the Import-Export Clause, the Contracts Clause, the Compact Clause, the Port Preference Clause, or the Privileges and Immunities Clause—time and again, from the central clauses to the seemingly mundane, it turns out that the Founders figured out most of the basic rules of what we now call competitive federalism.

The constitutional rules do not create a seamless competitive web. Strikingly, however, the courts of the nineteenth century gradually supplied the missing elements. The most obvious example of the judicial “invention” of a missing constitutional element is the “dormant” Commerce Clause. (Unlike the actual Commerce Clause, which authorizes Congress to protect *or abrogate* state competition, the dormant Commerce Clause cuts in only one direction—the protection of open borders and state competition.) Similarly, the right to free exit and entry, fundamental to a fully competitive federalism,

⁴⁵ Under the prevailing interpretation, of course, the Clause also authorizes Congress to protect state protectionism (as, for example, in the McCarran-Ferguson Act) or to “harmonize away” state competition.

is not explicitly contained in the Constitution, but the courts came to recognize it—belatedly, but correctly and without much interpretive artifice—as contained in the Privileges and Immunities Clause. (The principal problem here was not the principle but the politics: unlike the free movement of goods, the free movement of people was fatefully intertwined with the slavery question.) Pro-competitive rules likewise came to govern the choice between federal and state law, the delegation of federal powers to the states (and vice versa), the scope of the Commerce Clause, and much else besides.⁴⁶

For the most part, these lines of decisions reflect no more awareness of competitive dynamics than the Founders’ writings. They rather reflect the formalism of Thomas Cooley’s *Constitutional Limitations*, and the federalism they yielded was called “dual” rather than “competitive.” But dual federalism’s congruence with competitive dynamics was noticed and well understood *by its enemies*. The Progressives and, subsequently, the New Dealers characterized federalism as a “race to the bottom” and as a form of “destructive competition.” In a competitive environment where firms and citizens can move, a state’s citizens may feel compelled to choose a level of, say, workplace safety below level that they would choose under autarkial conditions. There are no interstate externalities in this scenario: competition itself is the harm. The competitive federalism answer to this maneuver is straightforward: in political as in private markets, competitive harms can never count as compensable harms. They are *damnum absque injuria*, lest the entire system collapse. But the defenders of the old, formalist order missed this point.

⁴⁶ See, respectively, *Crandall v. Nevada*, 73 U.S. 35 (1867) (right to interstate travel); *Swift v. Tyson*, 41 U.S. 1 (1842) (choice of federal common law in diversity cases); *Cooley v. Board of Wardens*, 53 U.S. 299 (1851) (delegation of federal powers); and *Hammer v. Dagenhart*, 247 U.S. 251 (1918) (limited scope of the Commerce Clause).

The New Dealers, unfortunately, understood it all too well. If one can understand the pre-New Deal Constitution as a competitive charter, one can understand the New Deal Constitution as the obverse: monopoly and cartelization at every level is its governing principle. The most obvious way to suppress state competition is central intervention. For precisely that reason, the New Deal Court expanded the scope of the Commerce Clause to cover purely in-state events. That, of course, is the point of *Wickard v. Filburn*.⁴⁷ A second way to suppress state policy competition is the partial federal funding of state-run transfer programs in exchange for harmonizing minimum standards. Following a handful of modest Progressive experiments, the New Deal created such programs on a large scale. The Supreme Court, beginning with *Steward Machine Co.*, declared them unproblematic.⁴⁸ Finally, the New Deal worked an enormous expansion of the *states'* extraterritorial powers: the reach beyond the borders compromises the all-important exit rights. That is the point of the foundational decision in *Erie Railroad*.⁴⁹

At one analytical level, the move from competition to cartel as the basic paradigm of constitutional organization suffices to trace the contours of the New Deal revolution. It is important to recognize, however, that monopoly was not simply an accidental and easily reversible policy preference, derived perhaps from the New Deal's abominable economics. That view of the matter underestimates the New Deal's internal logic and coherence. Rather, the New Dealers put a minus sign in front of every Madisonian premise and argued for empowering (rather than disciplining) government at all levels; for factional politics; and for constitutional instability.

⁴⁷ 317 U.S. 111 (1942).

⁴⁸ *Steward Machine Co. v. Davis*, 301 U.S. 548 (1937).

⁴⁹ *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938).

That project, one might think, should fail for lack of demand: Who would propagate a federalism for governments rather than citizens, or a federalism in the service of factions, or constitutional instability? Factions and politicians will tend to take that view. Almost by stipulation, they would be better off under a less constraining regime, and if that move means constitutional instability, the question is not whether they want it but whether they can be stopped. Less obviously, factions and politicians will take this tack *in response to*, not in defiance of, the voters' political demands. The intuitive appeal of constitutional constraints and stability depends entirely on an *ex ante* perspective. *Ex post*—that is, once the constitutional choice has been made—every rational individual can readily envision some departure from the rules that would leave him or her better off. Interest groups mobilize in anticipation of such rewards, and politicians respond to their demands.

Madison himself grasped the allure of *ex post* opportunism, as he grasped much else, without the aid of twentieth century theorems. Amid the stirring rhetoric of *Federalist* No. 45, his precision is easily missed:

*It is too early for politicians to presume on our forgetting that the public good, the real welfare of the great body of the people, is the supreme object to be pursued.*⁵⁰

It is too early because the sacrifices of the war are a recent memory. The actual possibility of acting on a set of *ex ante* preferences was purchased with the blood of thousands and the hard earned substance of millions. Once that experience recedes from

⁵⁰ *The Federalist* No. 45, 238 (Madison) (italics added). I am not the first to note this point. Bruce Ackerman quotes the passages here quoted on page 21, and calls attention to the italicized passage, to highlight Madison's keen understanding of the distinction between what he (Ackerman) calls "constitutional" and "normal" politics. Bruce Ackerman, *We The People: Foundations* (Cambridge: Harvard University Press, 1991), 178-79.

memory, parochial preferences will again gain the upper hand. The politicians can presume on our forgetting.

The New Deal, as it were, was explicit about the repudiation of Madisonian premises. The much-misunderstood enthusiasm for state governments as “laboratories of democracy” served profoundly anti-competitive intentions—the mobilization of political dynamics that would push redistributive state schemes onto the national level, and the mobilization of interstate exploitation. (The New Deal’s most pristine “federalism” experiment is the state-sponsored raisin cartel of *Parker v. Brown* notoriety, which reaped virtually all of its monopoly profits outside its home state of California.) The Supreme Court decisions that mark the transition from competitive to cartel federalism leave no doubt that the accommodation of interest group demands was a principal objective, and many of the New Deal’s architects were candid on this point.⁵¹ Likewise, the idea of a “Living Constitution” originated with the Progressives, whose principal target was precisely the set of constitutional arrangements that constituted competitive, “dual” federalism.⁵²

⁵¹ See, e.g., Edward S. Corwin, “The Passing of Dual Federalism,” *Virginia Law Review* 36 (1950): 1–24. The “cooperative federalism” literature of the New Deal abounds with celebrations of federalism’s openness to interest group politics. Consider a quote from a near-canonical text:

[A] system of many power centers is well suited to meet the infinite variety of expressed needs. . . . Because there are many points for decision, citizens and citizen groups have multiple opportunities to influence decisionmaking. If a group does not get satisfaction at one place, it can try another. And if the second is unresponsive, there may exist a third or fourth.

Grodzins, *The American System*, 335. Daniel J. Elazar, a leading architect and defender of cooperative federalism, has identified openness to interest group demands as one of its hallmarks: Elazar, “Cooperative Federalism,” in *Competition Among States and Local Governments*, 310.

⁵² While the phrase gained wide currency in the late 1920s and the 1930s, its origins can be traced to the beginning of the twentieth century. For discussions see Michael Kammen, *A Machine That Would Go of Itself: The Constitution in American History* (New York: Knopf, 1986), 219–254; White, *The Constitution and the New Deal*, 198–218; and Eric Claeys, (forthcoming).

If at this point the theory seems to collapse into well-rehearsed libertarian critiques of the New Deal, two non-obvious implications warrant mention. The first, already-mentioned implication is that the common account of the New Deal as a nationalist revolution is a misunderstanding (both historically and as a matter of political economy). The New Deal did not trample or impose upon the states; rather, it satisfied their demand for cartelization and, equally important, for the exercise of extraterritorial power. In short, the New Deal did not “kill” federalism but inverted it.

The second implication concerns the interpretation of the New Deal as a “constitutional moment.” In Bruce Ackerman’s account, “We the People” amended and transformed the Constitution in 1937, albeit outside the constitutionally prescribed channels.⁵³ In his view, the New Deal was “constitutional” both because it changed the basic constitutional arrangements (which is surely correct) and because “We the People” rose above normal, pathological politics and engaged in a higher “constitutional politics.” On my theory, the hallmark of the New Deal is precisely not the recognition of constitutional preferences but rather their wholesale substitution. The New Deal rules are those that surplus-maximizing Leviathans—and factions that hope to help themselves to a chunk of the surplus—would choose. No rational citizen would choose those rules at a constitutional level. In that sense, one could say that the New Deal was an anti-constitutional moment.⁵⁴

⁵³ Bruce A. Ackerman, *We The People: Foundations* (Cambridge: Harvard Univ. Press, 1991); and Ackerman, *We The People: Transformations* (Cambridge: Belknap Press, 1998).

⁵⁴ The disagreement here covers not only Ackerman’s but also Cass R. Sunstein’s version of the New Deal. On Sunstein’s view, the New Deal’s crucial discovery—exemplified, in his interpretation, in the Supreme Court’s decision in *West Coast Hotel v. Parrish*, 300 U.S. 379 (1937)—was that there is no neutral constitutional “baseline.” See, e.g., Sunstein, *The Second Bill of Rights* (2004). In my view, the New Deal Constitution does have a baseline—Leviathan’s.

IV. Inverted Federalism

After the New Deal, governments at all levels operate without structural federalism constraints—the national government, entirely so; the states, subject only to the weak limitations of the dormant Commerce Clause and its corollaries. This arrangement—concurrent power over the full range of government services and private transactions—translates into policy cartels. With respect to spending programs, the states’ default position is: “Give us more money, and leave us alone.” With respect to regulatory programs, their default position is: “Give us a regulatory floor without preemption.” States remain generally free to spend and regulate above any given collective baseline. In that sense, “competition” continues. Inverted federalism dampens and displaces competition only, and precisely, on the margins where the threat of exit would limit the states’ distributable surplus and constrain interest group politics.⁵⁵

Federalist policy cartels are neither frictionless nor entirely stable. Fiscal or other concerns may induce the federal government to demand performance for its money, and interest group pressures may yield preemptive federal regimes. Disputes over the terms of the intergovernmental bargain often produce public contention, as well as the fluctuations from federal “aggrandizement” to “devolution” (and back) that political scientists and journalists often mistake for “federalism.” But that is to be expected. *Private* cartels often disagree over the distribution of excess profits. Similarly, many federal countries have attempted to stabilize intergovernmental cartels at a constitutional level, typically through complex revenue-sharing formulas under a “Fiscal Constitution”—only to find that those

⁵⁵ State competition cannot be *suppressed* because a prohibition of one form of competition will induce free riders to “cheat” on a different, less efficient margin. For example, the (highly inefficient) selective tax benefits through which states seek to attract and retain industries can be viewed as a monetized form of competition that would occur on regulatory margins if that were permitted.

rules then prove highly unstable. But these difficulties affect only the dissipation of Leviathan's surplus, not the collective agreement to maximize it. That agreement itself is stable. The most convenient way of solving distributional conflicts is to pump more money into the system, and cartel federalism's rules facilitate that objective.

These dynamics and their imperviousness to politically induced change have been well-understood for at least a generation.⁵⁶ The only genuinely new federalism phenomenon since is the states' prominent role in regulating national commerce, culminating in their recently discovered ability to form tax and regulatory cartels *without* federal assistance in their creation or enforcement. The incentive for that conduct is the prolonged period of federal regulatory retrenchment and deadlock beginning in 1981, which induced a migration of regulatory demands to the states. Its viability is explained by the belated discovery of a major New Deal innovation, the demise of restrictions on the states' extraterritorial powers. Under conditions of perfect extraterritoriality, each state may regulate any transaction that has some connection to its territory, and its regulation will often operate as a nationally uniform tax on firms and their customers. No firm and no state can opt out of the first-moving state's regime; again, the only dispute is over the distribution of the proceeds. The 1998 tobacco agreement is the clearest example of such a spontaneous cartel, but the same dynamics are at work in antitrust law, pharmaceutical regulation, and other areas. The greatly increased size and operation of "horizontal" intergovernmental organizations (such as the National Association of Attorneys General) can be understood as a low-cost mechanism to reduce the states' transaction costs and to facilitate the distribution of excess returns. The condition of

⁵⁶ The analysis just sketched is not materially different from the late Aaron Wildavsky's. See *supra* n. 6.

perfect extraterritoriality predicts the range over which spontaneous state cartels will operate.⁵⁷

While the chapters on our inverted cartel federalism will contain some empirical description, their emphasis is on the political economy of the underlying rules—a big lacuna in federalism scholarship. With some notable exceptions, political economists have failed to bring their models to bear on our actual constitutional rules and arrangements.⁵⁸ Much, though, can be learned here. For example, a political economy analysis of the demise of the Compact Clause, a clear-cut textual barrier to federally unapproved state cartels, turns up a pristine example of constitutional inversion.⁵⁹

Political economy yields rich dividends not only with respect to constitutional federalism provisions but also with respect to *subconstitutional* rules. *Ex ante*, we can figure out the general rules that should govern intergovernmental relations. But those rules will be extremely rough, and their application is highly context-dependent.⁶⁰ (The

⁵⁷ In tax law, for example, extraterritoriality is imperfect because states may not impose tax collection obligations on “remote” sellers that have no physical nexus to the taxing jurisdiction. The attendant threat of exit and free riding has bedeviled the states’ attempt to create a uniform cartel for the taxation of e-commerce.

⁵⁸ Gordon Tullock, one of the co-authors of *The Calculus of Consent*, lamented the fact on the occasion of the 25th anniversary of the *Calculus*. Tullock, “The *Calculus*: Postscript After 25 Years,” in *Public Choice and Constitutional Economics*, 139–140. As every generalization, this one has notable exceptions. A handful of constitutional provisions—prominently, the Commerce Clause—have received significant attention in constitutional political economy, and political economists have tackled the separation of powers-arrangements of the Constitution (such as bicameralism and the presidential veto). See, for example, Saul Levmore, “Bicameralism: When Are Two Decisions Better Than One?” *International Review of Law and Economics* 12 (1992): 145–162; Frank Easterbrook, “Antitrust and the Economics of Federalism,” *Journal of Law and Economics* 26 (1983): 23–50; John McGinnis and Michael Rappaport, “Our Supermajoritarian Constitution,” *Texas Law Review* 80 (2002): 703–806; John McGinnis and Ilya Somin, “Federalism v. States’ Rights: A Defense of Judicial Review in a Federal System,” *Northwestern University Law Review* 99 (2004): 89–130.

⁵⁹ See Michael S. Greve, “Compacts, Cartels, and Congressional Consent,” *Missouri Law Review* 68 (2003): 285–387.

⁶⁰ For example, Leviathan theory yields a general principle that bars state discrimination against out-of-state commerce and market participants. But it yields no firm rules for the taxation of interstate income,

“right” jurisdictional tax rules may well differ from optimal rules for antitrust purposes, which may in turn differ from optimal rules for securities regulation.) The rational pre-constitutional individual will refrain from resolving these questions at a constitutional level and will instead decide to play in a second-best world. That second-best world is federalism’s warp and woof. It encompasses matters of jurisdiction, choice of law, federal preemption, and yet-more arcane questions which aspiring lawyers study in a class on “Federal Courts.” Although the field owes its place in the curriculum to the discovery that subconstitutional arrangements, as much as the constitutional chestnuts, shape federalism’s contours and operation,⁶¹ it has largely lost its connection to the constitutional structure. To my mind, the subject begs systematic examination.⁶²

V. Competition, the Constitution, and the Court

Scholarly curiosity aside, there is a second reason for concentrating on the political economy of federalism’s underlying legal structure: if cartel federalism embodies the authentic preferences of surplus-maximizing Leviathans and their clientele,

which hang on empirical assumptions about tax incidence, elasticities, and the like. Brennan and Buchanan, *The Power to Tax*. For an application see Stephen F. Williams, “Severance Taxes & Federalism: The Role of the Supreme Court in Preserving a National Common Market for Energy Supplies,” *Colorado Law Review* 53 (1982): 281–314.

⁶¹ Henry Hart and Herbert Wechsler, preface to *Federal Courts and the Federal System* (Brooklyn: Foundation Press, 1953).

⁶² The most obvious question is the nature of second-best rules that are consonant with competitive and cartel arrangements, respectively. Behind that inquiry lie the questions that tie subconstitutional rules to the *ex ante* perspective of political economy: Given the need to play in a second-best world over some range, how and to what extent would a pre-constitutional individual want to subject second-best choices to constitutional constraints? (How would pre-constitutional Leviathans answer that question, if the choice were up to them)? Normatively, how can one structure competing institutions that will tend to make competition-protective second-best choices with a modicum of consistency and reliability? One body of empirical and theoretical research suggests that that cannot be done. See, e.g., Jonathan A. Rodden and Susan Rose-Ackerman, “Does Federalism Preserve Markets?” *Virginia Law Review* 83 (1997): 1521–1572. See also Jonathan A. Rodden, *The Promise and Peril of Federalism: Hamilton’s Paradox* (Cambridge: Cambridge University Press, forthcoming). If that is right, what follows?

there is no viable political path to a more competitive arrangement. Constitutional rules, meaning federal courts, have to do most of the work.

For better or worse, the theory predicts that courts cannot do that work, either. The Constitution does not enact James Buchanan's social theory; and even if it did, the Supreme Court could not impose it. Even so, there is a meaningful difference between a set of rules that reinforce inverted, cartel federalism and its pathologies and an alternative set of rules that constrain it at the margin. The Courts of the post-New Deal (including the Rehnquist Court) era have consistently opted for reinforcing rules. I argue for constraints—rules that are based on the constitutional lodestar and value of competition.

The paradigmatic choice between cartel and competition applies across the board.⁶³ One obvious area is the suppression of state competition on the “social” or “moral” issues where it would otherwise thrive, from abortion to gay rights. The Court embarked on this course not for political economy reasons but *sua sponte*, and it could reverse itself *sua sponte*. The principal obstacle is its morbid fear of a more open, competitive politics.⁶⁴

A second application is federalism law itself. Here, competitive federalism stands opposed both to the “process federalism” of the post-New Deal era and to the Rehnquist Court's federalism. “Process federalism” denies the need for any judicial federalism on the theory that the states can protect themselves through the political process.⁶⁵ This view

⁶³ For a somewhat more extended discussion see Michael S. Greve, “How to Think about Constitutional Change, Part II: Originalism, Pragmatism, and the Constitution,” *Federalist Outlook* No. 23(2), Aug. 2005.

⁶⁴ Robert Nagel, *supra* n. 12.

⁶⁵ The classic formulation is Herbert Wechsler, “The Political Safeguards of Federalism,” *Columbia Law Review* 54 (1954): 1954.

rests on the mistaken notion that the states' political autonomy is an intrinsic rather than an instrumental federalism value. States can indeed protect themselves—and then collude, both with one another and with the federal government, against the citizens. Competitive judicial federalism guards against that manifest danger by having the Supreme Court act as a kind of political antitrust agency that protects competition, rather than the competitors.

That, of course, has not been the Rehnquist Court's view. Rather, the Court has embraced the mistaken premise that federalism is about protecting "states as states." Its lodestar is the state "dignity" so brutally derided by Madison. Instead of reverting to constitutional, *ex ante* presumptions, then, the Court has merely strengthened the position and reinforced the entitlements of one set of institutional actors (the states) against another set of actors (Congress and some distributional coalitions). A judicial federalism of this description threatens to exacerbate the pathologies of inverted federalism. A judicial federalism that is worth having, to repeat, revolves around state competition rather than "dignity" and reads the constitutional structure through that prism.

That perspective is orthogonal to the contemporary constitutional debate. For adherents of "original intent" or "original meaning," the admission that competitive federalism never occurred to James Madison settles the matter: what we have here is another assault on a jurisprudence of original intent, no different in kind from Dworkinian flights of fancy. For progressives theorists, any theory that maps pre-New Deal formalisms (albeit partially) is *ipso facto* pre-modern—a reactionary attempt to resurrect a discredited "Constitution in Exile." Competitive federalism, however, is

orthogonal to the originalist-progressive debate in a peculiar way: it takes the theoretical commitments on both sides of the debate more seriously than do the partisans themselves.

The Rehnquist Court justices who wear originalism on their robe sleeves are the first to decide federalism cases on the basis of structural imperatives, implied presumptions, and tacit understandings.⁶⁶ That move is precisely right, both because it is “originalist” in the right sense and because it is inevitable. The idea of a constitution as an institutional coordination game with more than one equilibrium outcome implies that the Constitution is open to “nationalist” and to “confederalist” interpretations—and to more than one plausible federalism theory. To the extent that we can determine the Founders’ intent, *they wanted it that way*. “Federalism” is not actually in the Constitution; it is shorthand for the architecture that connects and supports its elements. The question, then, is not whether one has to go beyond “original meaning” or “strict construction” to presumptions. The question is what the presumptions should be. The task is to lay them bare and to show that the results are congruent with the text, structure, and logic of the Constitution.

The seemingly lax demand for congruence and consistency proves remarkably stringent in its application to what now passes for federalism debate. The Rehnquist Court has mobilized the notion of state “dignity” *against* the constitutional text (for

⁶⁶ See, e.g., *Federal Maritime Comm’n. v. South Carolina State Ports Authority*, 535 U.S. 743, 753 (2002) (Thomas, J.) (quoting *Blatchford v. Native Village of Noatak*, 501 U.S. 775, 779 (1991) (“[W]e have understood the Eleventh Amendment to stand not so much for what it says, but for the presupposition of our constitutional structure which it confirms”); *Printz v. United States*, 521 U.S. 898, 905 (1997) (Scalia, J.) (“Because there is no constitutional text speaking to this precise question, the answer ... must be sought in historical understanding and practice, in the structure of the Constitution, and in the jurisprudence of this Court.”); *Nevada v. Hall*, 440 U.S. 410, 439 (1979) (Rehnquist, J., diss.) (“...Art. III and the Eleventh Amendment are built on important concepts of sovereignty that do not find expression in the literal terms of those provisions, but which are of constitutional dimension because their derogation would undermine the logic of the constitutional scheme.”).

example, in Eleventh Amendment cases).⁶⁷ Opponents of the Rehnquist Court's federalism, for their part, read non-trivial provisions (such as the Commerce Clause) entirely out of the Constitution and read other provisions (such as the Compact Clause) to mean the opposite of what they say. Competitive federalism, in contrast, takes the text, structure and logic of the United States Constitution seriously. It is *constitutional* federalism in a way in which its practically relevant contemporary rivals are not.

Within the bounds of the constitutional structure, varying accounts of federalism are still possible. But some accounts are better than others, and there are non-arbitrary grounds to decide the question. Internal coherence is one criterion; explanatory power is another; normative attractiveness is a third. Competitive federalism, I argue, satisfies those criteria in a singularly compelling way.

As noted, federalism may serve a range of only partially congruent values. The most serious alternative to the value of competition and its corollaries (such as diversity and experimentation) is the value trumpeted by progressive theorists—democratic participation and “empowerment.”⁶⁸ The New Deal did much to “modernize” the United States Constitution on this dimension.⁶⁹ What remains to be done is to extend and finish

⁶⁷ For a trenchant critique see Evan H. Caminker, “Judicial Solicitude for State Dignity,” *Annals of the American Academy of Political and Social Science* 574 (2001), 81–92. For a more passionate (though less subtle) critique see John T. Noonan, Jr., *Narrowing the Nation's Power: The Supreme Court Sides With the States* (Berkeley: Univ. of California Press, 2002).

⁶⁸ For a recent, powerfully argued though to my mind unattractive effort to infuse constitutional federalism with democratic, participatory values see Stephen G. Breyer, *Active Liberty: Interpreting Our Democratic Constitution* (New York: Knopf, 2005). For other versions of empowerment federalism see Ernest Young, “Two Cheers for Process Federalism,” *Villanova Law Review* 46 (2001): 1349–1395; Douglas T. Kendall, ed., *Redefining Federalism: Listening to the States in Shaping “Our Federalism,”* (DC: Environmental Law Inst., 2004); and Erwin Chemerinsky, _____ *Pepperdine Law Review* [TKTK].

⁶⁹ On the contemporary progressives' view of the New Deal as a distinctly modern transformation see G. Edward White, *The Constitution and the New Deal* (Cambridge: Harvard Univ. Press, 2002). Bruce Ackerman entitles his entire account of the New Deal transformation “Modernity”: *We the People: Transformations* 253. In a slightly different vein, Cass R. Sunstein has searched for a “useable past”

the work. The progressives are right to insist that any coherent federalism implies some normative commitment. But they have chosen the wrong commitment.

It is in fact very difficult to sustain “active liberty” in the teeth of the constitutional text and the underlying structure. For that reason, thoughtful advocates of “empowerment” federalism, who possess the courage and clarity of mind to think through the logic of their position, have come to rest their case on models outside the Constitution—Europe, for instance, and the Articles of Confederation.⁷⁰ These pre- or post-modern projects may hold attractions of their own, but “the fact is that our federalism is not Europe’s,” or for that matter that of the Articles.⁷¹

More fundamentally, a federalism program of empowering government at all levels does not readily translate into more democratic participation. Any halfway serious program of democracy enhancement must take account of interest group pathologies. It turns out, though, that empowerment federalism promotes “democracy” on precisely the margins where those pathologies are most dangerous. The expansion of the states’ extraterritorial powers liberates states to legislate, tax, and regulate in settings where domestic political constraints and exit constraints are both inoperative. The central provision of local goods entails a higher level of taxation and regulation than any

preceding the New Deal: Sunstein, *The Idea of a Useable Past*, *Columbia Law Review* 95(1995): 601–08. He downplays the transformation Ackerman emphasizes: if the Founders were already Proto-New Dealers and John Marshall, an early and slightly obtuse Felix Frankfurter, the New Deal was probably not a terribly big deal. Still, Sunstein shares Ackerman’s proud commitment to a progressive constitutional enterprise.

⁷⁰ See *Printz v. United States*, 521 U.S. 898, 976–77 (1997) (Breyer, J., diss); Hills, “Political Economy of Cooperative Federalism,” 942–44.

⁷¹ The quote appears in Justice Scalia’s majority opinion in *Printz*, 521 U.S. at 921.

jurisdiction would choose under competitive conditions or even in an autarkial world.⁷²

Intergovernmentalism diffuses political accountability, thus creating room for fiscal illusions.⁷³ Competition, it is true, constrains “democracy” (in a primitive sense) just as globalization and open borders constrain sovereign countries’ collective experiments. But competitive rules constrain precisely on the margins where “democracy” is most likely to translate into interest group exploitation and governmental surplus maximization.

The need for such discipline is particularly urgent under modern conditions. Under the banner of constitutional adaptation to a modern, more complex world, the New Deal created a federalism for politicians and interest groups, rather than citizens. To get around that awkward fact, progressives must construct a narrative of a New Deal that never was (an enormous intellectual investment, which suggests that the progressive commitment to progress is about as deep as the originalists’ commitment to original meaning). But there was nothing peculiarly “modern” about the New Deal even at the time, and there certainly is not now. Our economic knowledge and instruments have improved greatly, as has our understanding of the design and operation of political institutions. We understand, as the formalists of the Old Court did not, that exit and competition are salutary, potent forces. We understand, as the New Deal did not, that political cartelization and central management are precisely the wrong responses to an increasingly complex, fast-paced global economy. In the interest of the original

⁷² Economists can prove this proposition on a blackboard. See Buchanan & Tullock, *The Calculus of Consent* 135-40.

⁷³ For an extensive discussion see Michael S. Greve, “Against Cooperative Federalism,” *Mississippi Law Review* 70 (2000): 557-623.

Constitution and in the interest of a modern Constitution, there is ample reason to bring our improved understanding to bear on our bizarre, inverted federalism.

TABLE OF CONTENTS**Introduction****Part I
Constitutional Logic: The Founders' Choice**

Preface: Constitutional Political Economy

1. Constitutional Design
2. The Union and the States
3. Federalism, State to State
4. Supremacy and Courts
5. Constitutional Stability
6. Constitutional Inferences

**Part II
From Competition to Cartel: The New Deal Inversion**

Preface: The Death of “Dual” Federalism

7. Federalism's Metaphors: The “Race to the Bottom” and the “Laboratories of the States”
8. The Political Economy of the Commerce Clause
9. Declaration of Interdependence: Federal Funding
10. *Erie* Federalism: Unleashing the States

Part III
Constitutional Pathologies: Inverted Federalism

Preface: The Death, and Death, of Dual Federalism

11. Concurrent Powers: “Competition” Without Brakes
12. The Power to Tax
13. Federal Funding: The Entitlement State
14. Cartel Federalism: Tobacco and Beyond
15. Preemption as a Last Line of Defense

Part IV
Applications

16. Competitive Federalism and Democratic Theory
17. The Elusive Search for the Second-Best: The Rehnquist Court’s Federalism
18. The Federal Constitution, at Home and Abroad
19. Conclusion: Is Competitive Federalism Possible?