1

Constituting the Robust Federation

How can a federal constitution—mere words on paper—produce a government that is strong, flexible, and resilient? A federal constitution creates distinct governments endowed with different responsibilities. The boundaries between national and state governmental authority are set with goals in mind; to be effective, these boundaries must be maintained. At the same time, the constitution is not written to satisfy a single moment, but needs to remain relevant in perpetuity. Over time, owing to changing circumstances and intentions, the authority boundaries sometimes must be redrawn. The tension between strength and flexibility, commitment and mutability, creates a conundrum inherent to federal constitutional design. Making the problem all the more vexing, the safeguards that uphold the boundaries depend on humans, acting as both individuals and collectives, and are thus flawed. How successful federations overcome this apparent contradiction, enforcing the rules while maintaining flexibility—and do so with imperfect components—is the focus of this book.

This book builds a logic of robust federal design. I offer a set of general principles of constitutional construction and institutional performance that can be adapted to fit local conditions. I diagnose the inherent weakness of federalism: the temptation for constituent governments to exploit the union for their own gain. I show how the constitution constructs safeguards to prevent these transgressions, but each is imperfect and none is sufficient. As a collaborative system, however, the safeguards overcome one another's weaknesses to protect the federal boundaries against manipulation while admitting beneficial adjustments. By explicitly acknowledging the context dependence of institutional performance, we can understand how safeguards intersect to fashion a robust system: strong, flexible, and able to recover from internal errors.

Whether measured in population or gross domestic product, the world has grown increasingly federal,[1] making the need to understand federalism, and its constitutional design, ever more urgent. Emerging democracies turn to federalism with hope, as the solution to bind together diverse populations. But federalism is not a panacea: the federal structure is often blamed for political crisis, where observers complain that the federation is either over- or undercentralized. In many countries, federalism is touted as the solution to fiscal mismanagement, while in others—notably Argentina's 2000 economic collapse—federalism takes the brunt of the blame. What makes the problem interesting is that all ring true. Unlike its unitary cousins, a federation suffers from structural deficiencies that challenge its robustness: the very features that make a federal structure appealing for a heterogeneous society—decentralization and regional semi-independence—also build in new opportunities for transgressions.

To develop principles of robust federal system design, we need to understand what undermines a union from reaching its potential. Observations confound analysis because internal competition can lead to many different outcomes. The federation can grow too centralized, or spin out of control; pieces may secede, or the whole federation can crumble into autonomous entities. The center can grow so forceful that the subunits either rise up in challenge or wither into nonexistence, legally or in practice. A study focused exclusively on the United States would be tempted to conclude that the national government is the main threat to federal harmony, swallowing the states' authorities (what I will call encroachment). The U.S. federal government, after all, holds the lion's share of the purse strings and controls the military. But both factors are present in Argentina, with the opposite effect: paradoxically the provinces are both chokers and the choked, and they often cannot escape their own collective stranglehold. Americans begin to see that what is particular about their federation, the apparent overcentralization, might not be a universal tendency of federalism. The tendency of state governments to overstep their authority should not be overlooked. In federations there is no unique

[1] See Table 2.1. The 33 countries that were federal or quasi-federal in 1990–2000 made up about 50% of the world's population and contributed 61% of the world's GDP in 2000. Acknowledging China's quasi-federal *practice*—it has partially devolved significant authority, including economic planning, growth strategies, and welfare provision—the numbers leap to 70% of the population and 65% of GDP.

culprit that prevents the union from achieving its goals, no single cause of poor performance.

Nor do we observe a single recipe for success. While all federations are more institutionally developed than an alliance, none is designed identically, and even those with nearly identical constitutions grow informal institutions and evolve wildly different political cultures, as with Argentina and the United States. Despite the observational variance, there are properties—forces induced by the structure of federalism—common to all federations. Focusing on the common underlying forces, lessons learned studying the United States, Argentina, Canada, and Australia might prove instructive for Russia, Iraq, South Africa, and the European Union. To understand the general properties, we need to get to the root of what ails a federation; in the midst of such institutional variety, we need a fundamental understanding of how the constitution contributes to the well-being of its member governments.

The federal structure is adopted for a reason (often several, which vary from country to country); to achieve these ends, authority within the federal system is deliberately distributed between federal and state governments. This distribution may fail for two reasons: noncompliance and inappropriateness. Governments may fail to respect one another's authority; this opportunism throws the federation off balance, depleting its potential, perhaps even destroying the union. Transgressions are tempting when the rules are costly for the governments to follow. Therefore federal design cannot stop with the distribution of authority: it is also necessary to engineer a system to uphold the rules.

A second challenge is the match between the distribution of authority and the federation's needs and potential. The rules regulating federalism's boundaries may be poorly conceived from the start, a product of political compromise or asymmetric bargaining power, or they may become inappropriate over time, as the environment or public demand changes. The federal system needs a procedure for adapting the distribution of authority even as it upholds the existing rules.

Notice that federalism's second problem of adaptability contradicts the first, of compliance. Constitutional design faces a dilemma: the federation needs sufficient structural integrity—solving the compliance problem—to work in the short run, but the rules upheld must adapt to changing needs. Compliance maintenance makes the robust federation effective; adaptability keeps it relevant. Robustness requires both commitment and flexibility. A robust system of safeguards is strong enough to bind member

governments to the rules, but also sufficiently supple to adapt the rules. It is also savvy; it resists opportunistic manipulation.

To understand how a constitution overcomes this conundrum to create a thriving federation, one must look beyond the rules to the *system* created by the constitution. A constitution prescribes the government's formal structure, describing how the executive, legislative, and judicial powers will be implemented, whether there will be regular elections, and who counts as a citizen. Informal elements rise up as a product of these formal institutions, including the party system and political culture. Federal constitutions add a wrinkle of complexity: they replace the unitary government with multiple independent-willed governments, set within a hierarchy including one central government. All of these elements—including the governments themselves—act as safeguards of the rules.

Safeguards sustain rules in two ways: through coordination or force. When the only barrier to compliance is a common understanding of the behavior required, rules are upheld by institutions that publicize the meaning of the rules. Often the meaning itself is not clear and so the safeguards can serve double duty, aiding a deliberative process of determining the meaning of the rule (and so also allowing it to evolve, if necessary) and then publicizing it once determined. Sometimes rules prescribe behavior that a government would rather not follow; in these cases, compliance is upheld through safeguards that reward desired behavior, or more often, punish undesirable behavior.

Safeguards are not robotic, but staffed by humans, and so will reflect our tics and inconsistencies. The imperfection of these safeguards is the source of federalism's third challenge. Each safeguard forms its own judgment about what governmental behaviors to tolerate. When a safeguard is particularly intolerant it punishes frequently, making the union less beneficial to its members. On the other hand, when safeguards are overly tolerant they punish rarely, reducing the incentive to comply, again reducing the benefit of federation. The federal system of safeguards needs sufficient redundancy to recover from the errors made by its components.

The heart of the book is dedicated to understanding how the safeguards operate. It will not offer an ideal design—there is no "perfect" constitution in an appendix—but it does offer design principles. I offer a perspective that sees the safeguards as varying in their capacity to respond to different transgressions, varying in the force of their response, and varying in the causes of their own failures. These heterogeneities provide an opportunity to overcome the apparent dilemma of force and flexibility while providing

insurance against misjudgment. The key lesson of this book is that safeguards must be understood within their institutional context. Each has a role to play in the recovery from another's failures, in bolstering another's powers, and through their diversity, to provide a space for policy experimentation. It is their interaction that generates the strong, adaptive, and ultimately robust federation.

1.1 Federalism as Means

Resolved that the Articles of Confederation ought to be so corrected & enlarged as to accomplish the objects proposed by their institution; namely, "common defence, security of liberty and general welfare." —James Madison, *The Virginia Plan*, 1787[2]

Governments are designed to pursue society's goals. Most constitutional preambles remind the reader of this purpose, and James Madison's draft of the U.S. Constitution, *The Virginia Plan*, is no exception.[3] People form political communities for security (common defense), to ensure their rights (liberty), and to strive for widespread benefits such as a common market (general welfare). Some federations are founded with all three of these purposes in mind, while in others an initial concern births the union, and over time others are added. The European Union is an excellent example of an evolved federation; the union's purposes have expanded over time, and as the goals of the union expand, the institutions are adjusted to accommodate the changing goals. In Chapter 2, I explore the purposes of federalism in more depth and include an overview of the European Union's development. Following is a brief overview of the purposes.

[2] Madison (1999:89).

[3] Throughout this book, I build on the thinking of James Madison because Madison approached the design of federations as a problem of incentives: how to structure institutions to induce desirable political behavior. Madison may have invented modern federalism, but in a very real sense he had no alternative: a unitary government was out of the question, and the looser confederation had proven unsuccessful. His goal was to devise a system of government that would make the union thrive. Simultaneously he was concerned with the problem of democracy, since the early American experience with it had left many disgruntled. Therefore Madison began his study of federal design with a puzzle: to design a government to serve the people, specifically, to meet their goals and perform well over time, sometimes by overriding their immediate desires.

Just as Madison had no real alternative but to recognize state sovereignty, this book begins with the premise that federalism has been selected as the governmental form and thinks about the principles for constructing a federal constitution. For more on the origins of federalism, see Riker (1964) and Ziblatt (2006).

Military Security: With military power centralized, a federal union is better able to defend itself than a confederation or looser alliance of states. The strength that comes from an expanded territory and resources, as well as the improved coordination of effort, makes members of the federal union more secure against foreign invasion than they are on their own (the *Federalist*, Riker 1964, Ostrom 1971).

Economic Efficiency and Innovation: The science of fiscal federalism studies the design of taxation and expenditure policies between governmental levels in search of efficiency or to maximize total utility (e.g., Musgrave 1997, Oates 1999). With market-preserving federalism, decentralization coupled with other conditions such as decentralized fiscal control and hard budget constraints enables a state to commit credibly not to expropriate all rents (Weingast 1995, Parikh and Weingast 1997, Qian and Weingast 1997, Rodden and Rose-Ackerman 1997, Rodden and Wibbels 2002). Also, decentralization may spur beneficial government policy experimentation (e.g., Kollman et al. 2000). Intergovernmental competition, enabled through decentralization, may make government more efficient (Tiebout 1956). At the same time, a federation has a central government, often lacking in a confederacy, and centralized regulation of trade permits a polity to enjoy the benefits of a common market (e.g., the *Federalist*) as well as other financial standards, including common currency and interest rates.

Effective Representation: Madison emphasized federalism's potential to prevent tyranny and improve the quality of representation in the state and national legislatures, bolstering democracy's performance (the *Federalist*, Elazar 1987, Ostrom 1991). Others cite the value of decentralization: distributing authority at lower levels may serve as a pressure valve, releasing tensions in heterogeneous populations (the *Federalist*, Horowitz 1985, Stepan 1999). In the fiscal federalism literature, decentralization permits citizens to elect politicians who will tailor policy to meet local preferences or to provide an opportunity to move to states that better match their interests (Tiebout 1956, Inman and Rubinfeld 1992, Peterson 1995, Donahue 1997, Oates 1999).

1.2 Distributing Authority

Among the numerous advantages promised by a well constructed union, none deserves to be more accurately developed than its tendency to break and control the violence of faction. . . . Complaints are every where heard . . . that our governments are too unstable; that the public good is disregarded in the conflicts of

rival parties; and that measures are too often decided, not according to the rules of justice, and the rights of the minor party; but by the superior force of an interested and over-bearing majority. —James Madison, *Federalist* 10[4]

Even as he relays complaints (and to be sure, he agrees with them), Madison's optimism prevails. To say that the performance of government falls short is to measure it against a greater potential. Madison implies that a well-constructed government might respect political minorities, might be reliable, might reflect local interest while generating the efficiency of a centralized government. The design of government affects its ability to accomplish citizen goals. A federal structure gives constitutional designers the opportunity to fragment government geopolitically into independent governments, with direct governance of the citizens at each level.[5] Authority can then be distributed between levels of government. A federal structure becomes a tool that can be used by the people to craft a more effective government, with some authorities assigned to the national government and others to the states.

If the distribution is flawed, then the government cannot perform well. It can be flawed for a number of reasons. First, social science is imperfect. Designing the allocation of authority is a great problem in social engineering. People are not atoms; their actions and reactions surprise the institutional engineer. A perfect design would demand a perfect understanding of how people will react to complex, interdependent incentives, but for all of its advances, the scholarship to date has only an imperfect understanding of the relationship between the distribution of authority and the union's ability to reach its potential.[6] Second, any distribution of authority implies compromise. Not all objectives are complementary; pursuit of some ends compromises a union's ability to pursue others. If the union is evaluated only along the dimension that is sacrificed, its performance will appear lackluster. The third reason is a natural extension of the second: with heterogeneity in the population, some will prefer one distribution over another because of the asymmetric consequences. Subgroups within the population would rank potential distributions of authority differently. A fourth reason for poor design further extends this

[4] Madison (1999:160).
[5] See Chapter 2 for a complete definition of a federation.
[6] For two thorough evaluations of the relationship between decentralization and social goals that reach opposite conclusions, see Triesman (2007) and Inman (2007).

thought: the adoption of the distribution of authority may be affected by power asymmetries.

The second through fourth points underscore the delicacy of adapting federal boundaries of authority. Most studies of institutional effectiveness assume that players willingly enter into the incentive environment established by institutions. Moe (2005) warns against this overly rosy view of institutions because players subject to an institution's incentives may be forced to play according to rules chosen by another. There is reason to believe that in many cases the initial adoption of the federal constitution, including the distribution of authority, is voluntary. The history of many federal unions reveals holdout cases: Buenos Aires in Argentina, British Columbia and Prince Edward Island in Canada, and Great Britain in the European Union. In these examples, the federal subunits waited to sign until the federal arrangement was redrawn to their liking, or until they had more confidence that the distribution of authority would be respected, without endangering local interests. Moe's cautions about power become particularly important once the federation is established. The voluntary nature of the federal union dissipates after constitutional adoption. Exit, while possible, arguably grows costlier after joining, which makes exploitation more likely when power asymmetries are present.[7] Adaptation is critical to the robust federation, but the process should be able to discriminate against the dominance of particular interests over the societal whole, a crucial problem addressed in Chapter 7.

In short, the allocation (and exercise) of authority matters. In the preceding paragraphs I have described the need to make adjustments to improve the functioning of the government, but adjustments may also be opportunistic, to serve a subset of interests (back to Madison's factions), at the expense of the whole. Distributing authority requires rules, and rules may be broken.

1.3 Opportunism

The great desideratum in Government is, so to modify the sovereignty as that it may be sufficiently neutral between different parts of the Society to controul one part from invading the rights of another, and at the same time

[7] However, even here one may find examples of successful subunit resistance to changes to the federal arrangement. Consider the 2005 French and Dutch rejections of the European Constitution.

sufficiently controuled itself, from setting up an interest adverse to that of the entire Society. —James Madison, letter to Thomas Jefferson, October 24, 1787[8]

A federation is more than divided authorities; it also requires independent wills and the power to exercise them. It is not sufficient to divvy up authority between governmental units like any corporation, where the real power is exercised by one unit alone, which might at any moment reorganize or recapture the devolved authority. Should this happen, and the balance of authority be tipped in one direction or another, tyranny becomes a problem, and the society's other goals—security and the economy—may also be sacrificed. When the federation does not perform well, it is vulnerable to break-up, revolution, coups, and invasions. Respect for the distribution of authority will come when power, not just authority, is shared. It requires severing the dependence between governments and defending the union against the temptation of opportunistic behavior.

The distributional battles in a federation are symptoms of an underlying public good provision problem. The federal benefits often require that the member governments, both state and federal, put general welfare above their own apparent self-interest. This transformation is not going to happen by luck or divine intervention; it must be engineered through institutional design that can align self-interest with common interest. Chapter 3 describes why opportunism is an unavoidable threat to federal unions. A robust federation minimizes opportunism to maximize productivity. Opportunism is described in detail in this chapter, with examples. The federal government may *encroach* on the authority of the states; states may *shirk* on their responsibilities to the union; and states may *burden-shift*, imposing externalities on other states in the federation. Figure 1.1 captures the logical essence of federalism's compliance problem.

Notice how opportunism also interferes with adaptation, federalism's second problem. The federation needs to be able to experiment with new policies to adapt the distribution of authority optimally. But the temptation of opportunism makes toleration of experimentation hazardous. Opportunistic transgressions may be punished extra-constitutionally through revolt, but at a high cost; it is risky, and it requires significant coordination and a high level of consensus. It does not guarantee any improvement in outcome. Finally, popular revolt is virtually incapable

[8] Madison (1999:152).

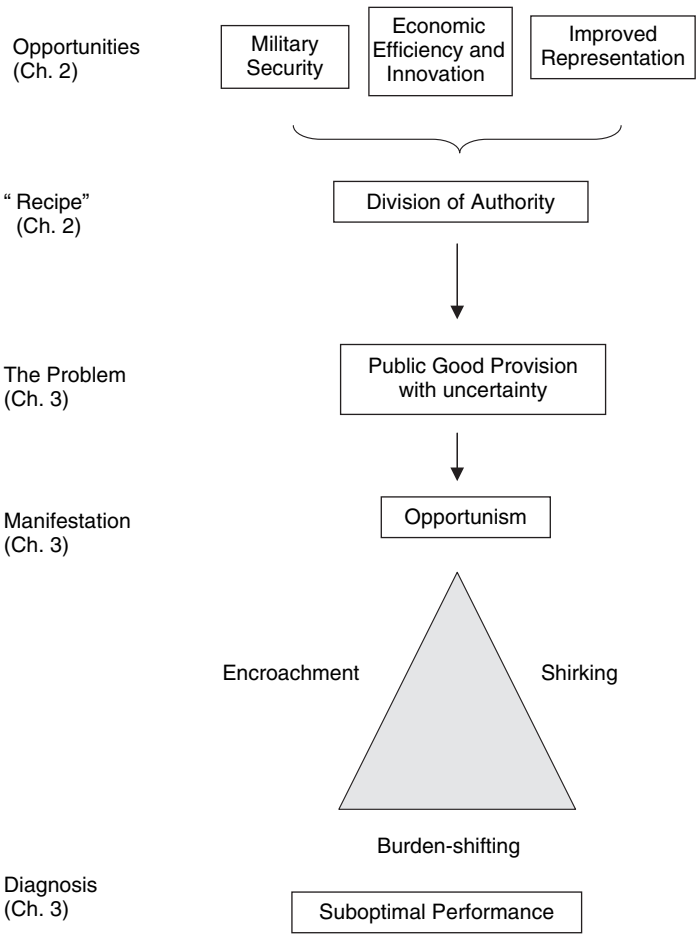

Figure 1.1. The Problem of Federal Robustness

of punishing burden-shifting—transgressions of one state on another. If this were the only control mechanism available to citizens, the government would have a wide berth before punishment through revolt would become likely. How can the citizens control their government without resorting to such extreme measures? It may seem unlikely that a paper document (if the constitution is written) could make a difference, but this book will break down federalism to its basic components to examine how a thoughtfully designed constitution may provide an institutional enforcement aid to the citizens.