

Theoretical Benefits and Limitations of Federalism

Centralization and Devolution in America

Key Themes and Questions

- Federal systems of government:
 - What are the major strengths and weaknesses of federalism?
- Federalism and policymaking:
 - How federalism shape state and national policy-making?
 - When does federalism lead to poor policy outcomes?

Benefits of federalism?

- Provides economic benefits
 - Market Preserving Federalism/Fiscal Federalism
 - Marketplace of Ideas
- Protects regional cultural, ethnic, and religious identities
 - Nation Preserving/Holding Together Federalism
- Encourages Policy Innovation
 - States are Laboratories of Democracy

Market Preserving Federalism:

Economic Security

- Provides for a common market
 - Permits free trade and free flow of goods and labor across states
- Promotes specialization and competition in both economy and public policy
 - Subnational governments compete for capital, labor, and economic activity
- Provides Regional Insurance
 - Geographic and economic diversity under a nationalized government provides security blanket and insurance

Why did thirteen currencies...



become one common currency?



Market Preserving Federalism

The Economic Benefits of Federation.

- Federal Central Bank/National Bank Independence
 - National government possesses sole power to print and coin money.
 - Fiscal discipline imposed upon state governments
- Common market/free market reduces barriers to flow of goods and labor
 - Local governments compete in federal marketplace.
 - Local governments can specialize and attract specific labor
- Larger market provides insurance and protection from regional recession.

The potential efficiency of the common market



Limited Economic Diversity



Economic Insurance:
Diversity of Economies



Federalism Promotes
a Market-Place of Ideas

- Citizens in a federation are policy consumers.
- They express preferences not just by voting.....
-but also by moving.
- They “vote with their feet.”

Federalism Promotes
a Market-Place of Ideas

- Subnational governments compete in part through differentiation in public policy.
 - Some governments provide high tax/high service policies.
 - Some governments provide limited tax/limited services.

Drawbacks of Marketplace of Ideas

- “Race to the bottom”
- State governments have incentives to compete for workers that generate high tax revenue and limited demands for state services.
- State governments may avoid enacting policies that attract low income workers who depend on state welfare expenditures and services.
- Race to the bottom occurs when state governments reduce programs to avoid being magnet states for lower income workers.

Race to the Bottom?



Key takeaways:

- Federalism has economic and political advantages.
 - Creates common market
 - Encourages economic and political competition
 - Allows people to “vote with their feet.”
- There are some potential disadvantages
 - Permanent structural transfers of wealth between regions
 - Competition produces a “race to the bottom.”
