

FEDERALISM AND INDIVIDUAL SOVEREIGNTY

James M. Buchanan

I have been both surprised and disturbed by two sources of opposition to efforts to move toward federalist structures in which political authority is divided between levels of government. I refer, first, to the opposition in Europe, mainly in Britain, to movements toward effective European federalism. Second, I refer to the successful agitation that blocked the proposed Conference of the States in the United States in 1995. What is disturbing about these sources of opposition to the very idea of political federalism is that both emerge from groups that are identified variously to be right-wing, conservative, or libertarian. We should not, of course, be surprised at all by socialist-inspired opposition to the federalist idea and ideal. Socialists have been and remain forthright in their desire to extend the range of politicized control over the lives and liberties of persons. But why should conservatives, classical liberals, or libertarians join socialists in opposing structural reforms that embody federalist principles?

I suggest that a coherent classical liberal must be generally supportive of federal political structures, because any division of authority must, necessarily, tend to limit the potential range of political coercion. Those persons and groups who oppose the devolution of authority from the central government to the states in the United States and those who oppose any limits on the separate single nation-states in modern Europe are, by these commitments, placing other values above those of the liberty and sovereignty of individuals.

The incoherence in values that such anti-federalist ambivalence reflects is not widely acknowledged. The relationships between federalist political structure and the sovereignty of the individual must be

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carefully examined, particularly in terms of the implications for current discussions in Europe, Mexico, and the United States.

In this paper, I shall summarize the theory of competitive federalism and examine the relation between the engagement-participation of the individual in politics and the size of the political unit. The theory of competitive federalism emphasizes the prospects for exit, both internal and external, as constraints on political control over the individual. In contrast, the theory of what we might call “partitioned sovereignty federalism” emphasizes the prospects for the exercise of voice in limiting political excesses.

In addition, I shall introduce moral elements that may emerge in arguments for federal political structures and relate those arguments to observed crises in modern welfare states. Finally, I shall apply the analysis more directly to discussions of movements toward federalist structures in several parts of the world.

The Theory of Competitive Federalism

The normative theory of competitive federalism is congenial to economists in particular, because it is simply the extension of the principles of the market economy to the organization of the political structure. The market economy produces high levels of value from which all participants benefit; persons are legally guaranteed rights of entry into and exit from production and exchange relationships one with another. If a good or service offered by a producer-seller is “bad” compared with goods offered by other producer-sellers, the prospective purchaser-consumer simply exercises the exit option and shifts his or her business to an alternative supplier. And the facts that profits are promised by marketing “good goods” rather than “bad goods” ensures that scarce resources will flow toward those uses that yield relatively high values. Suppliers remain always in competition among themselves, faced with the knowledge that demanders have available the continuing prospect of exiting from any ongoing economic relationship.

Normatively, the political structure should complement the market in the sense that the objective for its operation is the generation of results that are valued by citizens. By its nature, however, politics is coercive; all members of a political unit must be subjected to the same decisions. The prospect of exit, which is so important in imposing discipline in market relationships, is absent from politics unless it is deliberately built in by the constitution of a federalized structure.

Consider a large economy, characterized by liberty of resource flows and trade throughout the territory—liberty that is enforced by

a political unit, a government, that is coincident in extent with the effective size of the market. If politics could be restricted to the exercise of these minimal or protective state functions (the night watchman state), little or no concern need be expressed about coercive political intrusions on the liberties of citizens. As the experience of this century surely demonstrates, however, politics is almost certain to extend beyond any such limits. (We need not argue here about whether or not and to what extent expansions in the domain of politics are justifiable.) The problem becomes one of organizing the beyond-minimal politics of the “productive” and the “transfer” state so as to minimize the potential for political coercion or, stated conversely, to maximize the protected sphere of individual sovereignty.

It is here that the prospects for organizing the polity in accordance with federalist principles become exceedingly attractive. Federalism offers a means of introducing essential features of the market into politics. Consider, for example, a setting in which the central or federal government is constitutionally restricted to the exercise of minimal or protective state functions, while all other functions are carried out by separated state or provincial units. The availability of the exit option, guaranteed by the central government, would effectively place limits on the ability of state-provincial governments to exploit citizens, quite independently of how political choices within these units might be made. Localized politicians and coalitions would be unable to depart significantly from overall efficiency standards in their taxing, spending, and regulatory politics. And note that the feedback effect of potential exit need exert itself only on a relatively small share of economic decision takers. Even those citizens who might never consider migration in some Tiebout-like regime would be protected by the acknowledged existence of those few citizens who might be marginally sensitive to differential political treatment. Federalism serves the dual purposes of allowing the range or scope for central government activity to be curtailed and, at the same time, limiting the potential for citizen exploitation by state-provincial units.

Partitioned Sovereignty Federalism: The Exercise of Voice

The efficacy of competitive federalism depends directly on the operative strength of the exit option. The ability of persons to migrate and to shift investment and trade across boundaries serves to limit political exploitation. Recall, however, that in his seminal work, Albert Hirschman (1970) placed “voice” alongside “exit” in his examination of control institutions. In the market, exit is the dominant means

through which persons indirectly exercise control, and, as indicated earlier, federalism incorporates this means into politics. But the exercise of voice is also important, especially perhaps in politics, and this feature lends independent support for federal structures.

The basic logic is straightforward. If the concern is for the protection and maintenance of individual sovereignty against the potential coercion that may be imposed by political or collective action, the size of the political unit, measured by the number of members, becomes a relevant variable, quite apart from the presence or absence of an exit opportunity. And political authority may be deliberately shared between a central government and component units, with effective sovereignty partitioned among levels.¹

Consider, again, a large economy in which a central government, coincident in size with the economy, is limited to the carrying out of protective or minimal state functions. How should the extensions of political activity beyond these limits be organized? How should the public-goods and welfare state activities be structurally designed?

Even if citizens are predicted to remain locationally fixed, and hence within a single jurisdiction, so that exit is not a potentially effective means of institutional control at all, there remains a strong normative argument to be made for establishing relatively small, and coexisting, political units, all of which may be geographically contained within the boundaries of the economic interaction and the territorial reach of the central government. If persons are, for any reason, either unable or unwilling to exercise the exit option, actually or potentially, they may be able to exercise voice, defined here as activity that is participatory in determining political choices. And voice is more effective in small than in large political units. One vote is more likely to be decisive in an electorate of 100 than in an electorate of 1,000 or 1 million. Also, it is easier for one person or small group to organize a potentially winning political coalition in the localized community than in a large and complex polity.

But voice is more than a vote in some precise mathematical formula for measuring potential influence over political outcomes. Neither the set of alternatives among which political choices are made nor the preferences of citizens-voters are exogenous to the processes of political discussion. And it is self-evident that the influence of any person in a discussion process varies inversely with the size of the group.

Even if exit is nonexistent in reality, what we may label as “virtual exit” may be important and relevant in the internal discussion-choice

¹Roland Vaubel (1995) makes several of the same points that I emphasize here. Notably, Vaubel also used the “exit” and “voice” metaphors in the federalist context.

process. The mere fact that coexisting units of government exist and can be observed to do things differently exerts spillover effects on internal political actions. As a practical example, even though exit was of some importance, especially in Germany, the *observations* of Western economies, culture, and politics by citizens of Central and Eastern Europe were independently critical in effecting the genuine political revolutions that occurred in 1989–91. As an additional conceptual experiment, think about how much less vulnerable the communist regimes would have been if all of Europe had been under communist domination. Or imagine how prospects for the revolution might have fared in a world without television.

Note that the normative arguments for federalizing political authority made so far have not considered the relative economic efficiency of public goods delivery by the different levels of government. Those arguments suggest that, even if productive-welfare state functions could, in some ideal sense, be best carried out by the central government, there are offsetting grounds, based on what we may call “political efficiency,” for partitioning political choice (see Brennan and Buchanan 1980: Chap. 9).

Homogeneity, Moral Capacity, and Federalization

The effects of community size on the individual’s protection against political exploitation discussed so far are independent of any consideration of the homogeneity or heterogeneity of the constituent members of the separated state or provincial units. Even if the inclusive polity is made up of similar persons, there remains a normative argument for partitioning effective political sovereignty between central and state-provincial units of governance. If, however, we now introduce prospects for heterogeneity in the inclusive constituency, the argument for federalization is surely strengthened. Small units, defined geographically or territorially, are likely to be more homogeneous in makeup than larger units, and the individual is more likely to share preferences for political action with his or her peers than would be the case where political interaction must include persons who are considered to be “foreign,” whether the lines here be drawn racially, ethnically, religiously, economically, or otherwise. If the end objective is the minimization of politically orchestrated coercion, the individual will, personally, feel under less potential threat in a community of similarly situated peers than in a large community that embodies groups with differing characteristics.

Quite apart from the objectively identifiable characteristics that might allow an outside observer to classify persons into groups, the

size of the community also becomes relevant in its direct relationship to the moral capacity of the individual to share values with others. That is to say, homogeneity in values among persons may itself be related to social and locational distance. And those values may include community bonding, which may be expressed in terms of utility interdependence. A person may feel genuine empathy for other persons whom he or she classifies, internally, as members of his or her moral community, the boundaries of which are determined, in part, by numbers and by proximity. For example, I may share a common concern for the plight of persons who are citizens of Montgomery County, Virginia, or, more inclusively, for the plight of the citizens of Virginia, a concern that is either absent or much attenuated with reference to the citizens of Kern County, California, or of California itself.

In a paper that I presented at the American Economic Association meetings several years ago (Buchanan 1978), I argued that each of us has only a limited moral capacity. It is surely easier and more natural to feel sympathy for and care about others who are members of the same small community than it is to care for members of a large polity. I suggested, further, that a major factor in generating the breakdown of the welfare state was the shift of transfer activities to the central government and away from local communities in which political action might well embody a greater sense of interdependence. I suggested that the shift of political activities that must incorporate moral elements to levels of interaction that extend well beyond our moral capacities can only serve to exacerbate the emergence of raw self-seeking by groups of potential clients on the one hand and by those who feel unduly exploited on the other.

The argument here is, of course, related closely to F. A. Hayek's emphasis on our genetic heritage, which is basically tribal, and leads us to classify other persons into two groups—"us" and "them," or "neighbors" and "strangers." Hayek (1979) perceptively noted that only as these genetic dispositions came to be transcended by the culturally evolved norms for generalized reciprocity in interactions did the "great society," defined by the extended market order, become possible. We must recognize, however, that politicization, in itself, explicitly encourages the reemergence of tribal identities. Political action, regardless of how decisions are made, involves choices that are made for, and coercively imposed on, *all* members of the relevant political community. Anyone who is a participant is, almost by necessity, required to classify his or her own interests in juxtaposition against the imagined interests of others in the polity. Federalized structures allow for some partial mapping of politics with tribal identities. At

the very least, federalized structures reduce the extent to which tribal identities in politics must be grossly transcended. This consideration assumes relatively more importance if and as the moral linkages are locational, rather than strictly genetic.

Federalism as an Ideal Polity and Federalism in Reality

It is relatively easy to describe the ideal structure of politics for a large community, defined by territory or by numbers of citizens, if the overriding objective is the protection of individual sovereignty against political coercion.² A central government authority should be constitutionally restricted to the enforcement of openness of the whole nexus of economic interaction. Within this scope, the central authority must be strong, but it should not be allowed to extend beyond the limits constitutionally defined. Other political-collective activities should be carried out, if at all, by separate state-provincial units that exist side-by-side, as competitors of sorts, in the inclusive polity.

This definition of the idealized federalism is useful only because it offers a concrete objective toward which reforms in political arrangements may be directed. In reality, no existing political structure comes close to the ideal. Any constructive effort must therefore commence with an understanding of and appreciation for the politics that is observed to exist. "We start from here and now." This elementary fact should always be prefatory to any discussion of reform.

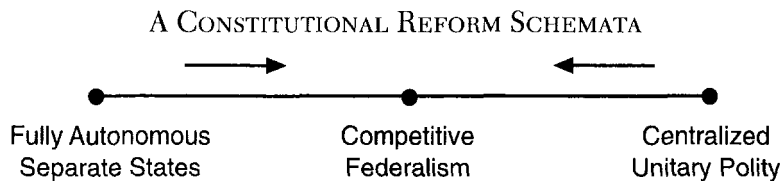
With reference to the common federalist ideal, however, we may observe categorically different starting places. The situation may be represented by the spectrum in Figure 1, in which a federal political structure stands halfway between a regime of fully autonomous states on the one hand and a monolithic, all-powerful central authority on the other.

Individual protection against political exploitation is increased as we move toward the center of the spectrum from starting points either left or right of center. In 1787, James Madison sought to increase the authority of the central government; he located the status quo under the Articles of Confederation somewhere to the left of center in Figure 1. He sought to increase the authority of the federal government as a means of placing limits on the authority of the separate states. We know now that United States history has destroyed Madison's vision. As a result of the destructive Civil War in the 1860s, secession was permanently eliminated as an effective extra-constitutional check

²The discussion in this section closely parallels that in Buchanan (1995).

on the progressive increase in central government authority. And, in the 20th century, constitutional guarantees against federal encroachment on the authority of states were undermined by executive, legislative, and judicial departures from established principles. At the century's end, therefore, the status quo is clearly on the right side of the spectrum in Figure 1. Effective reform must embody devolution of power from the central government to the states—change that is in the opposite direction from what Madison accomplished in 1787.

FIGURE 1



tory systems of political order. Federalism is a means of reducing political power overall and of dividing the power that exists. Socialism is opposed on both counts.

The opposition to federalism that comes from those who otherwise seem sympathetic to classical liberalism apparently reflects a failure to understand that federalism offers protection against the excesses of the autonomous nation-state. Or could it be that the genuine objective of those who oppose reforms toward federalism is not individual liberty, but rather the preservation of national political sovereignty? It is as if the U.K. anti-federalists are saying, "We do not mind being politically coerced, so long as it is done by the British Parliament."

The position of those zealots in the United States who successfully thwarted the organization of the Conference of the States in 1995 is even more bizarre and surely borders on paranoia. The initiative behind the Conference was aimed almost exclusively toward designing ways and means through which effective political authority could be devolved from the federal government to the separate states. How could those persons and groups who mouth slogans about liberty and oppose such initiatives be other than dishonest or ignorant?

Postscript: Individual Sovereignty and Individual Liberty

Note that my title is "Federalism and Individual Sovereignty" rather than "Federalism and Individual Liberty." It may be useful to clarify the distinction. What is the ultimate maximand when the individual considers the organization of the political structure? Unless he or she is a genuine anarchist who thinks that private and voluntary action can be efficacious over the whole social space (including basic protections to person, property, and contract), this maximand cannot be summarized as the maximization of (equal) individual liberty from political-collective action. Implementation of such an objective would, to many of us, represent a leap backward into the Hobbesian jungle.

A more meaningful maximand is summarized as the maximization of (equal) individual sovereignty. This objective allows for the establishment of political-collective institutions, but implies that these institutions be organized so as to minimize political coercion of the individual. Coercion is defined as being required to do things or to submit to things others do to you, that you do not, or would not, voluntarily agree to do yourself or to have done to you. A person may give up his or her liberty to steal from others and pay taxes to support the enforcement of laws against theft provided others are subjected to the same general constraints. So long as one's agreement to such

political actors in their attempt to maximize value. But the voice process itself is not essentially changed. The fact is that public choice analysts assume that the working of the political process under federalism remains the same at all levels of government as in unitary regimes. The exit mechanism is merely superimposed on politics as a constraint on decentralized authorities. It can therefore be argued that there is no specific economic theory of federalist politics. Only indirectly is the analysis of federalism related to the public choice tradition. Such an argument carries analytical implications in conditions in which “constitutional guarantees against federal encroachment on the authority of states were undermined by executive, legislative, and judicial departures from established principles” (ibid.: 266).

The Tiebout theory of federalism is based on the assumption of firm constitutional limits on the powers of the federal government. Once the division of powers breaks down, the functions of the two levels of government overlap more and more. Taking Canadian modern history as a case in point, Ottawa, along with the provinces, is active in most fields that constitutionally are the sole jurisdiction of the provinces: namely, manpower training and apprenticeship, social services, culture, housing, tourism, and sports and recreation. For the past 40 years, the federal government has shared with the provinces in the cost and implementation of the most rapidly expanding programs, such as medicare, higher education, and welfare. And of course equalization programs, which by nature affect all provincial fields, must also be included in areas of overlap. Taken together, these fields account for the bulk of the modern expansion in public budgets. The irony of it all is that despite the overwhelming role taken on by our central government, a large current of opinion in Canada holds that Canada is the most decentralized federation in the world.¹

In fact, everywhere today national federations find themselves in a situation in which two or more levels of government compete for the same voters in the supply of similar services in a given territory. By analogy, with the extraction of oil from a common pool by two or more producers, direct competition for votes by two levels of government gives rise to a common-pool problem. If one views votes as inputs in the production of political outputs, then it is in the interest of both government suppliers to seek to gain the votes in implementing programs first. Should one of them abstain from supplying the political output, the potential gain of votes would be lost in favor of its competitor. Competition in the absence of property rights results in waste through rent-seeking. Competition between two vertically structured

¹For a recent restatement of this position, see Andrew Coyne (1995: D5).

governments leads each one to attempt to realize the net political benefits for fear of losing them to its competitor. Yet, *ex post*, the political profit is dissipated for both.

One consequence of this process is a tendency for all levels of government to oversupply and to overregulate—in fact, to coerce potentially more than monopoly governments. Here is an implication of public choice under federalism that runs counter to predictions derived from the more familiar Tiebout line of analysis. That means there are two forces operating in a typical modern federal system, a coercive-expansionist force rooted in the political dynamics analyzed here and a restrictionist force based on the mobility of resources among decentralized entities. This distinction may explain why the empirical record is rather mixed on the contribution of federalism to containing government growth.²

A New Federalist Order

Despite the limits that history has placed on the action of federalism, I suggest that optimism remains the order of the day. Contemporary movement toward freer trade in goods and factors and toward common-market arrangements throughout the world provides a unique opportunity to overcome the drawbacks of monopoly government as well as the common-pool problem of multilevel government competition. The power of national governments to coerce in traditional federations mainly originates from a central government having the power to rule over the whole national area behind trade barriers. Now it seems that protectionism is no longer a viable alternative. In the last several years, various GATT-type arrangements, common-market treaties, and other freer-trade agreements within blocs have acted to constrain the power of national governments to maintain trade barriers.

Once protectionist impediments to exit are removed, national governments find themselves in the approximate position of a province or a state or a canton vis-à-vis the national economy in a federal state. The Tiebout mechanism comes into play, not mainly as a result of a new consensus on the virtues of limited government, but because the national government loses its traditional powers to rule over society and regulate the economy. The monopoly power of unitary governments, as well as the common-pool problem of federalist politics, can be alleviated to the extent that free movement of resources allows resource owners to move away from excessive taxes and regulations.

The determining characteristic of a federalist structure is extended to the international economy to the extent that responsibilities are

entrusted to authorities that have no power to tax or regulate the whole area in which trade is free. Not surprisingly, opposition to the North American Free Trade Agreement (NAFTA) came largely from Canadian and American environmentalists and organized labor, who feared increased competition from the expansion of opportunities in Mexico. That means that in most countries of this hemisphere, certainly in countries of the European Union and of North America after NAFTA, residents can more easily escape the burden of monopoly governments or multilevel competition either by purchasing their supply outside the country or by moving their assets or their person to neighboring countries offering more favorable legislation. Asset owners voluntarily enter the association endowed with the power to rule over them.

Free Trade as the Driving Force behind Government Withdrawal

I submit that the global movement toward free trade in the Americas, in Europe, and generally throughout the world after five rounds of successful GATT negotiations, is the real force working in favor of government withdrawal. This force of freedom, more than intellectual and technological changes, more than the realization that governments do not work, more than the intellectual awareness of the virtues of limited government, seems to be the dynamic behind the modern shift to "conservatism."

That such a movement is taking place can hardly be denied. It is visible everywhere in the greater reliance placed on freer markets, on the profit motive, on the sovereignty of the consumer, in the greater responsibility of people to take care of themselves and their families, and on the right of people to keep for themselves more of the fruit of their efforts. In turn, there is less reliance on progressive and higher taxes, on extensive social programs, on public enterprises, and on bureaucratic regulation of the behavior of workers and enterprises.

Even a traditionally social democracy like Canada cannot, after NAFTA, escape the trend away from interventionism. Deficit reduction by spending restraint dominates fiscal policy debates. Our traditional docility toward rising taxes seems to have waned. The pace of privatization is still lively. Government bailout of business has lost its appeal. Public opinion seems to be solidly behind reforms of unemployment insurance and welfare.

Nationalism as a Rationale for Decentralization

Buchanan deplors the fact that Europeans, the British in particular, readily accept being coerced, provided the coercion originates from

their own national government. That suggests that one should take a more philosophical approach to the question of nationalism as a rationale for decentralization. The public choice tradition has taught us to give little weight to how people rationalize their political and constitutional position. What matters more is that real forces and incentives work in the desired direction.

Economic analysts, and all free people, for that matter, need to resign themselves to an objective fact: that the competitive virtues of federalism, which serve as the basis for their enthusiastic support for this structure of government, are not a popular vision. Whether in Europe or in national federations, people can hardly conceive of their elected national government as not striving for the common good. How can a candidate to elective office elicit enthusiastic support for his or her candidacy to a necessary but failed, if not evil, institution? *Just recently, in my own province of Quebec, half the population was ready to jump into the catastrophic unknown of secession as a result of their faith in their provincial government. Not once in the referendum campaign were the competitive dimensions of federalism even mentioned by the defenders of the federalist structure. The partisans of secession, as good social democrats do everywhere, even made their case for separation as a shield against the "right wing" forces now invading the rest of America and threatening the Canadian social programs. Even in the recent confrontation over the budget between the Congress and the President, the virtues of competitive rivalries between component governments were seldom invoked. Rather, the movement was based on the belief that states can do a better job because they are closer to the people.*

Although intellectually disappointing, the appeal of devolution to nationalist forces need not depress federalists. There is an upside to that state of affairs. In common markets and free trade areas, people's faith in their own national government can serve as a protection against the risk of repeating the history of overcentralized national federations. That is clearly relevant to the European Union. Even in North America, the incorporation into NAFTA of side deals on the environment and labor has shown that we are not immune to the risk of a shift of power to the supranational level. In the campaign to overcome the powerful centralist forces at work everywhere, federalists need all the friends that they can find.

Constitutional Safeguards Less Urgent

In a more optimistic perspective than suggested by Buchanan, I would even submit that in a world where the federalist process is

forced upon us by outside conditions, namely free trade, the task of setting constitutional safeguards by political action loses some of its urgency. The international federalist competitive model comes into play without it being necessary to limit, legally or constitutionally, the legislative power of the various national governments, provided the mobility of resources is not hampered. In a decentralized system, such as occurs after free trade, exit, not voice, is the paramount instrument at the disposal of individuals to discipline their government and make their preferences known.

Centralization, Community Bonding, and National Survival

Finally, in support of Buchanan's opinion that "community bonding" is an active value in society that can preferentially flourish in a federal system, I would like again to offer the example of recent events in Canada. In Canada, the shift of transfer activities to the central government from local communities was not only instrumental in weakening the welfare state, but it has jeopardized the very survival of the Canadian federation. In contrast with what conventional wisdom would have us believe, the unity of a federation does not require a strong central government. Quite the opposite. Centralization is everywhere the enemy of harmony inside national communities, whether they be linguistic, ethnic, religious, or simply historical. Current threats to national unity in Canada are evidence that antagonisms rather than peace and social cohesion are likely to result from attempts by central authorities to engage in vast redistributive operations between regions and communities.

Such a situation is not limited to Canada. The collapse of centralist regimes in Eastern Europe and in the former Soviet Union should serve as a reminder that wealth redistribution by a central authority does not bring national or ethnic communities closer together. It is doubtful that the political integration of East and West Germany has yielded more advantages than would have been created by two distinct market-oriented economies with free movement of goods and factors (see Becker 1990). Subsidizing the continuation of inefficient uses of labor and capital in the eastern part is causing more conflicts than promoting national reconciliation. Whether in the former Soviet Union, Turkey, Canada, the former Yugoslavia, or in Europe as a whole, decentralization seems to be a major instrument to tame ethnic feuds. When minorities have more local autonomy within loose federations and more freedom of trade and movement across borders, they are less likely to feel oppressed and harbor hostilities. In effect, they

are more likely to assimilate freely into the larger wholes in the long run. Moreover, under free-trade regimes, large-scale migrations are made less necessary and less likely by movements of capital and goods.

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