

WHAT KIND OF FEDERALISM?

The Upside-Down Constitution

by Michael S. Greve (Cambridge, MA: Harvard University Press, 2012)

American conservatives usually insist that a return to federalism is needed to limit the federal government's regulatory and fiscal profligacy. Transferring power to the states is necessary to ensure that the federal government spends wisely, regulates prudently, and does not inhale the nation's treasury into its centralizing vortex. Conservatives usually observe that federalism was abandoned by the New Deal, which launched the federal debauchery now threatening the republic's existence. That was the moment when America's constitutional commitment to keeping most political decisions local was overturned. The states became the servants of the federal leviathan.

Lost to historical memory, and perhaps to conservatism's modern intellectual founders, is that American federalism is not only a *vertical federalism* between Washington and the states but also a *horizontal federalism* of formal state equality in the union *by and for the individual liberties of citizens*. Michael Greve of the American Enterprise Institute argues in his new book that recovery of *both* vertical and horizontal federalism is necessary for the restoration of our Constitution. The basic error, Greve contends, is in thinking that if only America had more federalism then it could be healed of its present sicknesses. This oft-spoken view, Greve

argues, ignores the more basic question that must be answered: *What kind of federalism?*

America in its founding moment became what Publius famously called a country that is "partly national, partly federalist," as distinct from a consolidated nation or, even worse, a confederate league of statelets. Federalism exists in numerous countries: Canada, Germany, Mexico, Argentina, and India, to name a few. But almost nowhere was federalism designed to operate in a competitive jurisdictional framework as in America. Most federalist systems, Greve observes, operate by a system of fiscal transfer payments and baseline agreements among the central government and the provinces. Transfer payments and regulatory agreements then provide a tax and regulatory surplus extracted from individuals for the central and state governments (and, most important, for their political and business elites). This makes sense; after all, states or subjurisdictional entities in most federalist nations loathe competition, and they prefer colluding with the central government for

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surety in rents and transfer payments, even at the expense of their own liberty to govern.

This comparative perspective helps make clear the significant achievement of America's individual-centered Constitution and its competitive federalism. Competitive federalism best expresses the breadth (enumerated powers) and depth (acts on individual citizens) of the constitutional powers of the federal government. Absent enumerated powers and the limits these place not only on federal power but also on state extraterritorial powers, the competitive structure of the Constitution breaks down. Instead, government at all levels becomes empowered to regulate. Accordingly, under competitive federalism the states possess formal equality within the union and control in governing their own internal affairs. However, the states are prohibited from applying their tax and regulatory powers in a manner that imposes extraterritorial barriers to trade and the free movement of citizens. State budgets are legally and functionally distinct from the federal government. To be livable for citizens, the states must make themselves lovable, and the rules of federal power under the Constitution mandate this course (or did, once upon a time).

Greve makes this point by discussing specific prohibitions that the Constitution places on the states' conduct. Article I, Section X, significantly limits states from doing the following: taxing imports or exports unless they pass the revenue to the federal government, laying tonnage duties, or forming compacts with other states without congressional consent. Article IV, Section II, protects the rights and immunities of citizens in any state where they reside or conduct their affairs. Moreover, the commerce clause's purpose of creating an open continental market means that states cannot shield in-state commercial interests from competition through any type of legislative device.

While vertical federalism provides that many decisions are made by those closest to specific political problems, the federal government must operate directly on the citizenry in certain matters if a free continental republic is to thrive. If state governments were able to shield their citizens from direct federal action, then the states as states—and not individual citizens—would be the functioning principals of the union. If this were the case, the states could interpose any number of barriers to fiscal and regulatory competition and commerce, as well as limiting the rights of noncitizens within their borders. Greve's insight is that "our federalism"—the way we live and govern now—displays many of these same tendencies.

Surprisingly, Greve argues that the New Deal Constitution was not built on mere centralization. The real revolution was its embrace of states as states, with their particularizing interest-group politics. This, in turn, launched a spending and regulatory avalanche from *both* the federal and state governments. On the dramatic spike in spending on cooperative programs during the New Deal, Greve notes:

Revenue figures tell a familiar story of government growth over the course of the New Deal—and a less familiar story about centralization. Although federal revenues rose considerably with the onset of the New Deal, an increasingly large share found its way into state and local budgets. . . . Newly enacted grants programs . . . enabled the states to procure federal funds for activities that previously had to be financed from own-source revenues.

Likewise in regulatory policy: "Not a single New Deal regulatory regime unambiguously trumped or displaced the states." Justifications of the New Deal frequently cite feder-



The New Deal: did it really end federalism?

alism’s coordination problems and the “race to the bottom” conundrum that effectively prevented labor and commercial regulations because of state competition and migrating businesses. If, however, New Dealers rarely nationalized regulatory and fiscal policy, and invited the states into their government-empowering project, then this explanation of the New Deal’s purpose is inaccurate. It is certainly the case, as Greve records, that states did not as a rule contest the constitutionality of New Deal “power grabs.”

In the case of labor and industrial regulation, the federal government invited states to pile their own edicts on top of national standards, or else to be recipient partners in redistributive programs. This was hardly efficient for redistributive policies. More sensible would have been for the federal government exclusively to direct such programs, given the costs and inefficiencies, if not graft, that came with involving state bureaucracies in administering them, unless the aim was to combine federal and state spending and regulatory patterns in order to

subvert the competitive constitutional structure. But—and this is where conservative wisdom is correct—the enumerated-powers doctrine that had guided the Constitution and kept state anticompetitive behavior at bay was made hollow by the New Deal, and with that, competitive federalism was abandoned. What we have now might be termed “cooperative federalism.”

Greve looks to the infamous 1938 *Erie Railroad Company* case as the embryonic judicial form of our contemporary federalism. In *Erie*, Justice Louis Brandeis held that in a federal diversity case (a suit between citizens of at least two different states), the choice of substantive law to be applied would be state law (including state common law) and not federal common law. Overruling a century of precedent built on federal common law, *Erie* held that there was, in fact, no such thing as federal common law that courts could apply in their decisions. The attempt to impose federal common law violated separation-of-powers and federalism principles and was for Brandeis a metaphysical exercise mocked by a modern understanding of law.

Prior to *Erie*, in the absence of a controlling state statute, citizens and corporations, if sued in a federal diversity action, knew that federal common law would determine the outcome. The benefits that flowed from generally applicable rules to interstate commerce and its participants were many. In *Erie*’s wake, defendants became subject to an array of state rules, and this inaugurated its own race to the bottom, as states with harsh liability rules, for example, were increasingly able to apply them to extraterritorial conduct. Underscored by Greve is that *Erie*’s empowerment of states to reach defendants extraterritorially is one they continue to develop and exploit in new and fanciful ways.

Greve then considers the *Carolene Products* case and its famous footnote four—the

basis of rational and strict scrutiny analysis of equal-protection claims—handed down the same day as *Erie*. This case marked the Court's recognition that its New Deal principles, which had blessed state-based business cartels, posed threats to the rights of individuals. *Carolene Products'* seductive dance is composed of two movements: (1) recognition that much protectionist economic legislation by states, formerly violative of the commerce clause, was protected so long as it had a rational basis; therefore, (2) individuals seemingly unable to protect themselves in the political process (“discrete and insular minorities”) should receive heightened protection. Thus did the Constitution become a rights-based document instead of one that protected liberties through structural separations of power.

One might conclude that understanding the decline of competitive federalism after these crystallizing political and judicial events merely completes the scorecard. Growth obviously has continued in redistributive programs and regulatory imposition. The method of regulatory organization switched from industrial classification to subject classification, i.e., environment, energy, transportation, etc., and fiscal programs morphed into block grants and partnerships with states. The danger to the republic has magnified by several factors.

The revenue transferred to states by the federal government shields them from accountability, escalating their fiscal irresponsibility. Greve observes that most citizens unknowingly receive state benefits that are not fully funded by their state's own-source revenues. Accordingly, state officials promise programs knowing that the state treasury will be filled by federal dollars that will defray the full costs. This practice, moreover, is one to which no state objects: the benefits to the public and the politicians are too great. Nothing, however, prompts

recovery of long-discarded ideas quite like existential failure.

The federal government cannot maintain its current entitlement spending. States owe four and a half trillion dollars in unfunded pension obligations, and the implicit bailouts of state governments in the 2009 stimulus legislation only delayed cooperative federalism's judgment day. The real question is how it all will end, given that state and federal debts that cannot be repaid never will be. Significantly, sectionalism may return and help revive competitive federalism's virtues of governmental restraint. The difference is between states that are open to commerce—and, I would add, natural family life—and thus are willing to shape their policies accordingly, and states that have followed the “blue model” of social and economic regulation, leaving them desperate for more infusions of federal revenue. This rising competition is already palpable and might lead to responsible states deploring the continued intervention of Washington with the sop it extends to bad states' behavior. Desiring to survive and prosper, and spurred by depleted federal coffers, successful states, in the political avenues open to them, might begin to openly attack the dominant course of “our federalism.”

If so, the slow return of competitive federalism and the benefits it affords individuals might become our practice once again. Greve is less than sanguine but points to the competitive constitutional structure as one that does not sanction contemporary trends in federalism. Crucial pieces of the original architecture still exist—most notably, tax and labor competition among the states. The Constitution is also a written document; presumably, it may still be recovered, for it contains the truths of our American order. A larger question remains, however, about whether the American people are still capable of responding to the Constitution's truths and the moral commitments it presupposes.