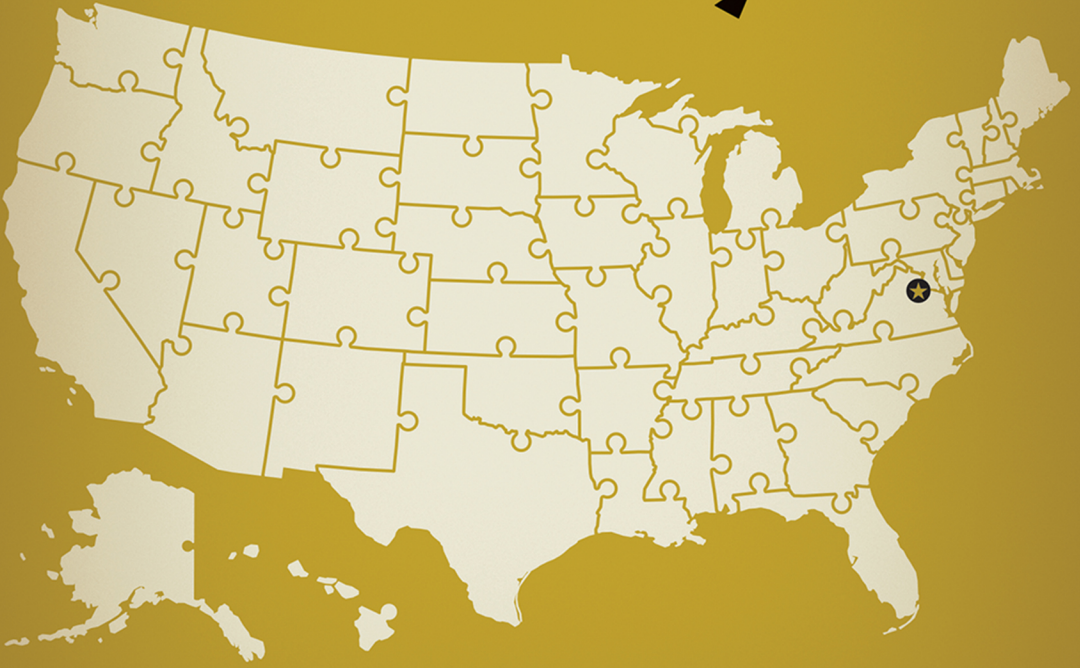


Perspectives on Political and Economic Governance

American Federalism Today



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Introduction

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Long an exemplar of successful political and economic governance, democratic capitalism is facing renewed critiques and challenges, both internal and external. Externally, it is argued that democratic capitalism is in decline, sclerotic, unable to make important decisions quickly enough given internal squabbling and excessive focus on material reward. The argument continues that it will be replaced by a more authoritarian state-directed system, sometimes labeled state capitalism.

Internally, battles have emerged over the legitimacy of democratic capitalism, particularly the United States' constitutional republic and its institutions. Calls to pack the Supreme Court, add new states to get more senators, and abolish the Electoral College have risen in frequency and volume.

America's system of governance differs from most advanced democratic capitalist societies, which rely primarily on a parliamentary system with fewer internal checks and balances. The American system, founded in rebellion against the British monarchy, created an intricate series of institutions designed to balance various interests. Equal representation in the Senate combined with proportional representation in the House; a constitution with separation of powers among the executive, legislative, and judicial branches; and the Tenth Amendment expressly limiting the scope of federal powers.

America relies relatively more heavily on subnational governments than most other nations, and the scale and scope of the federal government has grown over time. The debates about the proper role of governmental versus private and, within governmental, national versus state and local, have been among the most defining of the American experience, from ratification of the Constitution through the Civil War and responses to World War I, the Great Depression, World War II, and beyond. Thus, the subject of federalism lies at the core of American economic and political governance.

The distinction as to what is federal and what is subnational contains many nuances. For example, many federal government programs are executed by sending funds to state and local governments to provide services or to disburse; the federal government imposes many regulations and mandates on state and local governments; and states are constantly suing the federal government seeking judicial relief from federal diktats.

The papers, presentations, and discussions in this volume, individually and collectively, from some of the nation's most eminent scholars and practitioners, provide perspectives on and analysis of American federalism, and prescriptions and policies to improve it.

Legal scholar Michael W. McConnell leads off by discussing why the framers chose a partly national, partly federal structure for the new nation. As McConnell notes, "This contemplated a genuinely national government, with representation from the people (and not just the states) and power to enforce its own laws through a vigorous executive and an independent judiciary, but the states would retain political autonomy and authority over the issues most significant to ordinary life. The powers of this national government would be confined to certain enumerated objects, primarily foreign affairs and interstate commerce. This was an innovation; there were no precedents in world history for such a mixed system."

Political scientists Morris P. Fiorina and Alice Yiqian Wang trace historical and contemporary trends in public opinion about federalism and the scope of national power. They document that public attitudes toward federalism respond to partisan orientations and perceptions of changes in the scope of federal power. They uncover evidence that the 2020 COVID-19 pandemic shifted public attitudes toward circumscribing the scope of national power.

Historian David M. Kennedy recasts the conventional historical wisdom of "American federalism as a story of successive phases that added up to a cumulative advance of central at the expense of peripheral power." Kennedy concludes that it is historically more accurate to view "the coevolution of the two that has amplified the overall presence of governments (plural) in many sectors of American life. Indeed, federal power has often been the factor driving the scope and scale of state governments."

Economist John F. Cogan traces this evolution through the spending powers of the federal government. He concludes that the originally intended, and perhaps still perceived, sharp division between federal and state government responsibilities no longer exists. "Indeed, the breadth of federal spending is so large that it is hard to think of a state or local government activity that isn't

also financed by the federal government.” He describes vigorous debate in the early history of the republic, which generally adhered to Madison’s view of limiting federal spending. He notes the barrier separating state and local activities from federal spending started to fray when Congress funded internal improvements within state boundaries. The federal budget remained a small percentage of GDP (gross domestic product) and federal budgets were generally balanced, at least over time, with surpluses reducing debt accumulated in wartime and economic downturn. Shortly before World War I, state and local spending in the aggregate exceeded federal spending and the total was modest. Cogan traces the rising share of federal outlays on what were traditional state and local activities from the 1950s to 2019, a share that more than tripled. Among several interesting counterfactual experiments he describes “what the budget would have looked like if all non-social insurance revenues were applied to financing Madison budget expenditures.” Madison budget expenditures would have declined from 13 percent to 6 percent of GDP, and the federal government would have had budget surpluses except during wartime and recessions, patterns similar to the early decades of the republic. He observes that while the Constitution gave Congress the power of the purse, presidents have played an influential role in either restraining or expanding federal spending.

Political scientists David Brady, Jacob Jaffe, and Douglas Rivers utilize a series of YouGov polls from March to October of 2020, the early months of the COVID-19 pandemic lockdown and recession, to answer a series of questions, including how much partisanship affected trust in government, whether it was different across different levels of government, and did it seem to respond to the competence of government. They conclude that measurable performance, not just partisanship, played a role in evaluating the competence of the federal government and that partisans were “much more likely to approve of government performance where the relevant level of government was controlled by a copartisan.”

Political scientist Jonathan Rodden studies the effect of federal funds on public-sector employment by examining the ratcheting up of federal support for states with each recession. He documents that “recessions are associated with significant increases in reliance on intergovernmental transfers among state governments, but declining aid from states to local governments.” The effect has been particularly pronounced in large states.

Economist Eric A. Hanushek details America’s complex governance and fiscal structure for K–12 education. While the states predominate, local

districts on average “generate an equal amount of funding to the state,” but “the details of the state-local split vary dramatically across the states.” Federal funds focus primarily on poor children and those with special needs. He documents the relatively poor performance of US schools in terms of achievement, and he also concludes by raising the question of the relative roles of parents and school districts. “Over time, various types of school choice have expanded, signaling an increased role of parents. At the same time, the number of school districts has declined precipitously, leading to larger school districts that place decision making farther from individual parents.”

Economists Michael J. Boskin and Valentin Bolotnyy discuss the role of infrastructure in the federal system. They inventory America’s vast array of types of infrastructure, where “sometimes ownership is public, sometimes it’s private, and sometimes it’s something in between.” With the impending large infusion of additional federal infrastructure spending, they lay out principles that would enable higher social returns from the spending. These include establishing greater capabilities and incentives for rigorous, nonpolitical, cost-benefit analysis; financing through user fees wherever possible; planning for technological change; and focusing federal policy on proper incentives. They debunk the idea that federal infrastructure spending is effective short-run economic stimulus and discuss the poor incentives and fiscal cross-hauling in infrastructure matching grants.

Economists Thomas MaCurdy and Jay Bhattacharya analyze the complex federalist system of healthcare financing. They provide a comprehensive overview of healthcare funding and insurance, the growth of government healthcare financing, the large and growing role of healthcare financing in the federal budget, and policy options for addressing the impending fiscal crisis in public financing of healthcare. They conclude that while there are valuable opportunities to increase consumer-directed healthcare—competitive bidding in Medicare, state Medicaid reform, and allowing states greater flexibility in regulating private health insurance—the funding gap will remain immense unless more radical reforms limiting spending are adopted.

Economists Joshua Rauh and Jillian Ludwig analyze “the increasing federal financing of state-run programs,” with special reference to unemployment insurance and Medicaid. They explore whether there has been “greater implicit centralization of state and local government debt and unfunded pension liabilities.” They conclude that “many state liabilities have become de facto federal liabilities.” They analyze not only longer-term trends, but the effects of crises, especially the 2008–9 global financial crisis and the

COVID-19 pandemic, during which the federal government's role expanded dramatically as state and local systems came under financial pressure.

Political scientists Paul E. Peterson and Carlos X. Lastra-Anadón analyze the system of competitive federalism. Competition among state and local governments can generate greater efficiency by providing services, taxation, and regulation according to local preferences, while redistribution is carried out by the federal government. Analyzing data over three decades, they show that this division of responsibilities remains more or less intact, but since 2021, “changes in the intergovernmental system,” including enlarged grant programs, “posed a challenge to the structure of competitive federalism.”

Economist John B. Taylor discusses macroeconomic aspects of, and implications for, federalism. While at first glance federalism seems to be primarily about microeconomics, the macroeconomic framework against which the roles and responsibilities, the taxes and spending, the deficits and debt of subnational governments play out is immensely important. For example, stronger economic growth will increase revenues and decrease the demand for some social programs such as unemployment insurance. Inflation and monetary policy influence interest rates, including that paid on state and municipal bonds. Importantly, the macroeconomy and monetary policy affect the federal budget and the availability and desirability of federal grants to state and local governments. Against this conceptual backdrop, Taylor shows the implications of a preferred path to normalization of monetary and fiscal policy, especially because the federal budget will require considerable consolidation in future years due to unsustainable deficits and debt levels and additional pressures for funding Social Security, Medicare, and defense. How fiscal and monetary normalization occurs will have dramatic impacts on the future of state and local budgets and federalism.

These essays are buttressed by the insights and critiques of four prominent economists and political scientists strongly versed in the subject of federalism: Daniel L. Rubinfeld, Thad Kousser, Dennis Epple, and Thomas Nechyba, and by the discussion elicited by the papers and their commentary.

Finally, the collection of essays and insights is complemented by presentations by, and discussions with, three of the nation's most seasoned and respected practitioners in our federal system. Former governors Mitch Daniels of Indiana, Jeb Bush of Florida, and Jerry Brown of California relay their insights, achievements, and frustrations in dealing with federal-state and state-local relations in their time as governor and beyond. With their experience spanning states from different regions, with different political

orientations (Florida was a swing state when Bush was governor), the governors reveal real-world factors influencing decision making in areas from education to infrastructure to taxation and more. They also bring to light limitations on, and avenues for strengthening, American federalism.

The confluence of ideas and action represented in the essays and presentations in this volume constitute a valuable multidisciplinary resource for all who seek to understand, evaluate, and improve American federalism and the important role it has played, and continues to play, in America's economic and political governance.