

# Designing Federalism

*A Theory of Self-Sustainable  
Federal Institutions*

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## Federations and the Theoretical Problem

Federalism is the main alternative to empire as a technique of aggregating large areas under one government.

Riker 1964: 5

Federalism is commonly understood as a theory of government that uses power to check power amid opposite and rival interests. Authority is limited, and no single body exercises supreme control nor has a monopoly over the use of force in society. But the idea of federalism is rendered trivial when applied only to the coexistence of state and national governments. Rather, federalism offers no less than an enabling basis for the development of self-organizing and self-governing capabilities under conditions of equal liberty and justice.

Ostrom 1991: xi

### 1.1 Why Federalism

Before we can develop the preceding argument, we should first consider the reasons why federalism is often deemed a desirable governmental form, along with some definitions and the classic explanations for federal political stability and instability. We can begin by noting that, at a more detailed level than the assertion by Riker with which we introduce this chapter, federalism has two general justifications, one economic and the other political.<sup>1</sup>

The economic justification should be well known. Government (i.e., coercive) action may be required to resolve those market failures associated with informational asymmetries, externalities, and wholly decentralized decision making over public goods. However, public goods in particular vary in their

<sup>1</sup> For a survey of the classical justifications of federalism, see Kenyon and Kincaid (1991); Inman and Rubinfeld (1996); Qian and Weingast (1997); Breton (2000); Kincaid (2001).

characteristics, which, in turn, may require different treatments by different levels of government. For example, if the demand for such a particular government service varies with geographic location, if some public good is more efficiently produced locally, if the externalities associated with its provision and consumption have a limited geographic domain, if there are reasons for believing that information about the demand and supply of public services is necessarily more evident to local and regional polities than to national ones, or if economies of scale in the production of such goods can be realized adequately at subnational governmental levels, then the decentralized decision making that is assumed to characterize federalism – decision making that encourages competition among political subunits and the monitoring of public officials by those directly affected by their actions – allows for a more appropriate treatment of public policy. On the other hand, if there are significant externalities in consumption and production that cross political geographic boundaries, or if there are extensive economies of scale, then the treatment of “market failures” by a more unitary government can, in principle at least, better resolve market failures. The ideal federalism, then, is one that allocates the responsibilities of the state across levels of government according to rational criteria. Moreover, because technology, taste, and our understanding of things are never static, the decentralization and political competition that federalism allows offer the possibility of designing a state that can, in principle at least, move back and forth between acting in a centralized versus a decentralized way, and that makes such adjustments over time and across issues according to fixed democratic rules, especially those safeguarding individual rights.

The political justifications for federalism are somewhat more varied. They include allowing minorities – ethnic, religious, linguistic, or otherwise – the autonomy they often demand as “payment” for their acquiescence to the coercive powers of the national government, allowing for the protection of the rights of those minorities as well as the rights of all others in the federation, and allowing for local and regional control of purely local and regional matters so as to discourage the alienation that people might feel from a more distant and seemingly less controllable central government. In theory at least federalism allows individuals to join those with whom they share similar tastes for government services, thus opening the door to a general level of welfare – and, presumably, a degree of satisfaction with political institutions – unavailable to a unitary state. Federalism also is intended to allow for the decentralization of conflict, a mechanism whereby political barriers are established so as to preclude purely regional conflicts from disrupting national politics. Finally, those political entities who would form or join a federation may not be willing to abrogate their political authority wholly, and a degree of regional autonomy is often the only compromise that allows the establishment of a viable state in lieu of uncoordinated action.



Our purpose here, however, is not to survey in detail the purported benefits of federalism, the presumed advantages of federal versus unitary forms, or even the extent to which those benefits have in fact been realized in one federation or another.<sup>2</sup> We assume simply that such benefits exist and are theoretically attainable, and we assume as well that a federal state of some type either exists or that the decision to create one has been made. Our goal is not to justify federalism per se. We are not specifically concerned with such matters as whether Britain should be federal, whether the dismemberment of Yugoslavia is a good or bad thing, or whether Quebec should be allowed to secede from Canada. Rather, *after a decision to be federal is made*, our goal is to identify the structure of a federal state's political institutions – constitutional and statutory – that best encourage survival and its ability to meet those economic and political objectives that otherwise justify its existence.

The reason for the institutional focus implied by the preceding sentence is twofold. First, historically at least, federalism, sometimes seemingly independent of how well it has accomplished its economic or political objectives, has not been a notably successful governmental form. The ultimate character of American federalism, including the basic feature of the supremacy of federal over state law, was determined only through a civil war, even though the country at that time could not be said to have been experiencing any great economic or (intra-white) ethnic crisis. Canada's federal stability remains precarious despite that country's relative prosperity, while Nigerian democracy has failed repeatedly.<sup>3</sup> Federalism in Mexico has, at least in the past, been more cosmetic than real. Democratic federalism in Argentina has only recently reappeared after a fifty-three-year hiatus. The Czechoslovak federation was dissolved even though its economic and ethnic conflicts arguably paled in comparison to other states, including some surviving federations. The dissolution of the Soviet Union seems only to have intensified the economic difficulties of its component parts and opened some of those parts to the rise of communal conflict. And few people argue that the survival of Russia as a *democratic* federation, regardless of how much money the International Monetary Fund (IMF) sinks into it, is assured.

<sup>2</sup> For one study that raises questions about the value of decentralized federal decision making in emerging democracies and developing economies, see Wibbels (2000), who argues that in a federal state “the coordination of national fiscal and monetary policies as adjustment tools is complicated, posing a challenge to national economic stability” (p. 688), and that “the price of ongoing decentralization in the federal systems of the developing world can be quite high” (p. 699).

<sup>3</sup> The First Nigerian Federal Republic started with Nigeria's independence in October 1960. The military overthrew the government in January 1966 and ruled until September 1979. The Second Republic lasted from October 1979 to December 1983, when the military resumed the control (Diamond 1988). Nonmilitary democratic rule was restored in May 1999. Yet in the first three years since military rule ended, more than 10,000 people are believed to have been killed in ethnic and religious clashes (*New York Times*, February 24, 2002).

The second justification for our focus on institutional design is our argument that the institutional variables commonly attended to in federal design – constitutional clauses pertaining to federal subject representation in a national legislature, the identities of federal subjects, the right or prohibition of secession, the supremacy of federal law, comity, the rights of federal subjects in amending a national constitution, and statements prescribing the policy jurisdictions of federal subjects versus the national government including the authority to tax – are not the uniquely critical parameters that need to be attended to. First, such clauses cannot guarantee their own enforcement, and unless they are somehow fortified by direct incentives for political participants to uphold them – unless, in the jargon of political science, they are deemed legitimate by the population generally, or, in the jargon of economics, unless they are made a part of an incentive-compatible system in which political actors find it in their self-interest to abide by them – they become mere “parchment barriers” and irrelevant to actual political processes. This is not to say that such clauses and constraints are unimportant, and it is essential that some of them be assigned specific values (e.g., prohibiting secession). But they are not sufficient for the smooth operation of a federation, democratic or otherwise. We must also attend to a second level of design that structures political processes generally, with a clear understanding of how constraints of one type interact with institutions that might otherwise seem tangential to federal matters. Thus, the things that are often omitted from the list of a constitution’s explicitly “federal provisions” – the authority of a chief executive, the organization of the judiciary, and the structure of a separation of powers – are, as we argue subsequently, also critical institutional dimensions of design.

A central argument of this volume, however, is that federal design cannot stop even here, since doing so fails to address the issue of enforcement – in this case, the enforcement of the constitution as a whole. Designing a federation, then, requires that we attend to a level of institutional structure that deals specifically with individual political incentives. Some parts of this third level are formally stated and, therefore, subject to an explicit blueprint. Other parts are informally defined and, thereby, serve more as constraints on our architectural enterprise. Still other parts correspond to what we might term spontaneously generated institutions – institutional structures that arise in response to the other components of a political system but which, once formed, exert an influence that needs to be understood if we are to understand the requirements of federal design generally. The formal (and, in some instances, the spontaneous) components of this third level, which consists of such things as the political institutional structure of federal subjects and the local, regional, and national laws that shape party systems, typically receive scant attention when federal design is discussed but are crucial to the issue of self-enforcement as well as federal stability and performance.

Of course, at this point there is little reason to suppose that the logic of our argument about the scope of federal design is clear or persuasive. Nevertheless, our focus on institutions is dictated as well by the simple fact that formally defined institutions are the *only* things at our disposal when designing a federal state. Although we can assume that society's culture and traditions are critical determinants of the likelihood that constitutional democracy can flourish within it, we cannot assume that we can mold the human psyche, political culture, or even the structure of an economy. Although certainly influenced by institutions in the long run, the purposeful manipulation of such things, even if possible, lies in uncharted territory. Thus, if a democratic state, federal or otherwise, can be implemented, this inevitably requires the judicious selection of political institutions based on a comprehensive understanding of how alternative institutions interact with each other and with the prevailing political environment, and how they shape and are shaped by people's motives and actions.

## 1.2 Definitions

### *Federalism*

Before we can even outline our argument, we should state some of the ground rules of analysis. First, we do not want to debate alternative definitions of federalism. We can, if necessary, adopt a definition such as Riker's (1964: 11), which identifies a federalism as a state in which "(1) two levels of government rule the same land and people, (2) each level has at least one area of action in which it is autonomous, and (3) there is some [constitutional] guarantee . . . of the autonomy of each government in its own sphere." With this definition or any other, however, we cannot envision a classification of states into discrete federal and unitary categories that would not be subject to criticism or require any number of footnotes. Does the autonomy allowed some of Spain's and Ukraine's regions render those states "federal" despite the fact that their constitutions make no mention of federalism per se? Is the United States "less federal" today than in say the nineteenth century when state and local revenues dwarfed those of the national government? If our answer to this question is yes, then do we need to offer a definition of federalism that allows for a continuous concept rather than discrete categories? The fact is that every government affords local authorities some degree of autonomy, and every ostensibly federal state exhibits (of necessity) a degree of central control. Thus, regardless of what definition we apply, it is apparent that federalism is not a concept amenable to an unambiguous descriptive definition.

The problem of definition is perhaps most readily understood by considering some of the substantive differences within these cases. To begin, Table 1.1 shows the considerable variability among federations as to the fiscal autonomy of federal subjects relative to the national government.

TABLE 1.1. *Subnational Governments' Revenues as a Percentage of Total Government Revenue*

	1997	1995	1990	1985	1980	1975
Argentina	39.8	37.3	37.7	16.5	25.0	—
Australia	32.7	33.0	28.3	25.8	24.3	24.1
Austria	24.4	27.3	26.9	28.5	26.3	28.1
Belgium	6.0	6.3	5.4	6.0	5.2	—
Brazil	33.8	—	25.0	21.8	24.3	—
Canada	52.3	53.8	52.7	52.6	52.6	47.8
Former Czechoslovakia	—	—	20.3	—	—	—
Former Yugoslavia	—	—	78.1	72.9	73.1	20.0
Germany	32.9	33.9	35.2	35.5	36.7	37.2
India	33.0	34.2	32.7	32.1	33.4	32.7
Malaysia	15.2	15.6	17.7	13.6	15.3	13.8
Mexico	22.9	20.9	20.7	19.9	18.5	19.3
Pakistan	—	—	—	—	—	22.8
Russian Federation	40.7	38.2	—	—	—	—
Spain	19.3	16.1	16.1	14.8	11.1	4.9
Switzerland	43.2	43.8	50.3	52.1	47.3	48.3
United States	41.7	41.5	41.7	39.9	36.6	39.6

Source: The data are selected from the *Fiscal Decentralization Indicators*, International Monetary Fund, available at <<http://www1.worldbank.org/publicsector/decentralization/fiscalindicators.htm>>.

Thus, even though all countries listed are (or were) federations, this measure of the fiscal autonomy of federal subjects suggests that Germany and Australia are “twice as centralized” as the United States and Canada, and three times as much as Switzerland. McKay (2000: table 3), however, offers an even more interesting table on the data from which we base our Table 1.2 that augments his findings with additional data and countries. As he summarizes his data, “[i]n the USA, Switzerland and Canada, borrowing is effectively controlled by market discipline alone or, in the case of the USA and Switzerland, by state constitutional and other limitations. In Germany, rules require borrowing to be confined to investment needs, while in Australia borrowing rules are agreed on jointly by the states and the federal government” (McKay 2000: 33). Again, even if we ignore the European Union (EU), which is the purpose of his comparisons, the important point is that there is considerable variation in the character of fiscal relations across states that are universally taken to be classic examples of the species.

Tables 1.1 and 1.2 reveal but a small fraction of the differences we can document across federations. In addition, we could consider, for example, differences in the allocation of policy jurisdictions (such as the administration of social security), the earmarking of specific tax sources to specific

TABLE I.2. *Fiscal Arrangements and the State Role in National Tax Decisions in the Late 1990s*

	Australia	United States	Canada	Germany	Switzerland	India	Russia	European Union
State tax conformity <sup>a</sup>	Yes	Very little	Yes	Yes	None	Yes	Yes	None
State tax uniformity	Yes	No	Little	Yes	No	Little	Yes	No (except min. VAT rate)
Single tax administration and collection	Yes	No	Yes	Yes	No	No	Yes	No
Central authorities account for most taxes	Yes	Yes	Yes	Yes	No	Yes	Yes	No
Transfers to subnational governments from other governments, 1995 <sup>b</sup>	39	30	24	24	23	40	15	-
Central government controls state-level borrowing	Yes	No	No	Yes	No	Yes	Yes	Yes

<sup>a</sup> State tax conformity and state tax uniformity refer to the extent to which constitutions and federal governments require federal units to standardize tax types and rates (McKay 2000).

<sup>b</sup> Percentage of total subnational revenues and grants.

Sources: McKay (2000); *Fiscal Decentralization Indicators*, International Monetary Fund, available at <[www1.worldbank.org/publicsector/centralization/fiscalindicators.htm](http://www1.worldbank.org/publicsector/centralization/fiscalindicators.htm)>.

levels of government, the structure of federal subject representation in the national government, and the role of federal subjects in determining national policy generally. We should also be cognizant of the fact that the character of a federation itself may undergo fundamental change so as to belie the adequacy of any definition. For example, we might suppose that the locus of control of defense and monetary policy is a sure way to differentiate between federations and confederations. But even here we must confront the fact that the United States relied largely on state militias through the mid-nineteenth century and did not possess a central bank between 1832 and 1913. An alternative way, then, of defining the subject of this volume is to examine answers to a series of more specific and restrictive questions. For example, we can ask whether a state, to be deemed federal, must be explicitly identified as such in its constitution. Are all self-proclaimed federations, including democratic ones, necessarily federations in substance? Must the national government in a federation take a particular form – must it have, for instance, an upper legislative chamber with “meaningful” authority and explicit regional representation? What role does the word “sovereignty” play in a definition of federalism vis-à-vis a federation’s constituent parts, its federal subjects? Is there anything necessarily hierarchical in a federation’s intergovernmental relations, or is its structure best described as a matrix with no ranking applicable to its cells? Is there anything mystical about the number two, or can we imagine federations with three or even four or more autonomous levels of governmental structure?<sup>4</sup> Are we necessarily limited to a geographically defined conceptualization of federal subjects – why not subjects defined in terms of occupation, ethnicity, or the language one uses in the home?<sup>5</sup>

<sup>4</sup> Any meaningful description of the Swiss institutional system, for example, would necessarily emphasize its three-tiered system of government: (1) the communes, at the local level, (2) the cantons, at the intermediate level, and (3) the Confederation, at the national level. In particular, the Swiss system is based on the sovereignty of both the cantons and local communities. The federal government cannot bypass cantonal governments to address local governments, either to impose or to negotiate fiscal or financial matters or the regulation and provision of public goods. Conversely, local governments lack formal direct access to the national government (Dafflon 1999).

<sup>5</sup> One can speculate about the feasibility of a nongeographically defined federal system. Why not a system, for instance, in which as in the former Soviet Union, interests are given representation and some degree of autonomous governance? Renner and Bauer (cited in Linder 1998) suggest that nonterritorial federal forms may be an important means of resolving ethnic issues (see also Ra’anan 1990). Geography assumes its importance largely for exogenous reasons such as the historically difficult matter of efficiently organizing governance among a geographically dispersed population, which is a reason that may fade into obsolescence with new technologies of communication. Equivalently, there is the simple fact that many of the goods and services that concern collective action possess an important geographic component to their descriptions. For an analysis of a *functional* federalism that is based on nongeographically defined identities, see Casella and Frey (1992) and Laponce (1995).

That satisfactory answers to such questions, universally acknowledged as such (see Scharpf 1997), elude us despite decades of research suggests that wrangling over definitions and classifications is not a productive way to proceed toward a general theory of federal design. The consequence of such wrangling, in fact, is the absence of any consensus over what would constitute a general theory or even an overall conceptual scheme for thinking about it. Unsurprisingly, then, a fluidity and vagueness of ideas commonly substitutes for theory, and scholars seem compelled to speak of a “spectrum of federal societies” (Livingston 1952), a “continuum” of federal regimes, and “varieties of federal arrangements” (Elazar 1995). The fact of the matter is that federalism is not a primitive theoretical construct, and it can be identified, if it can be identified at all, only after we possess a theory of democratic decentralization that offers a clear specification of theoretical primitives and their logical relations that allow for fluid and sometimes ambiguous definitions of subsidiary concepts and constructs.<sup>6</sup>

Thus, rather than contribute to any conceptual or definitional wrangling, for purposes of this volume we shall say simply (and no less vaguely than our predecessors) that a state is federal if its governmental structure can be characterized by multiple layers (generally national, regional, and local) such that at each level the chief policy makers – governors, presidents, prime ministers, legislatures, parliaments, judges – are elected directly by the people they ostensibly serve or (as with judges) appointed by public officials thus directly elected at that level. To this we will, as a matter of convention, suppose that the subgovernments within a federation are geographic in nature. If a reader wishes to substitute a different definition, we are open to suggestions; we offer this one merely to outline, however imprecisely, the domain of our subject. The reference to elections in our definition, however, makes it clear that we also want to limit our subject matter to *democratic* federations, although, as with the concept of “federation,” we do not want to contend fully with the definition of democracy. For example, although allegations of corruption along with undue governmental influence in the mass media permeate Russia’s electoral processes, the entry of politicians and parties seems sufficiently open, even following the political “reforms” of 2000–1, to allow us to categorize Russia as a democratic federation, albeit an imperfect one. In contrast, the Soviet Union, although ostensibly federal, was not democratic,

<sup>6</sup> In this respect we recall the wrangling that occurred over the concept of power in political science through much of the 1950s, 1960s, and, 1970s. No satisfactory and generally accepted definition was ever, to our knowledge, achieved, and, indeed, once the individualistic rational choice paradigm gained acceptance in the profession, such wrangling ended with the understanding that theorizing about politics could proceed without a formal definition of power. Once a more comprehensive and logically structured paradigm appeared, power was seen to be little more than a convenient linguistic shorthand and certainly not a theoretical primitive.

and we have little interest in identifying institutions that would facilitate the stability of such an entity.<sup>7</sup>

Our subject matter, then, encompasses the usual suspects – Canada, the United States, Germany, India, Switzerland, Australia, and Russia.<sup>8</sup> But even though states such as Spain, Italy, and Ukraine do not call themselves federations (indeed, the meaning and content of federalism are hotly debated in these countries),<sup>9</sup> the combination there of democratic process and regional autonomy makes them susceptible to similar challenges as confronted by the formally federal states. In fact, our study becomes especially relevant there if they eventually choose to become more explicitly federal and if we want to understand the debates surrounding the choice of alternatives. Similarly, although monetary union does not by itself make the European Union a fully formed federation,<sup>10</sup> the lessons we develop here can be applied to this entity as well. We hope to show, in fact, that the EU, absent a significant overhaul of its basic structure and a reformulation of its theoretical underpinnings, is unlikely to function with the efficiency of, say, the U.S. or German models.

There is one final reason for preferring a relaxed attitude toward the definition and delineation of the object of our study. As will hopefully become clear as we proceed, a federal state is not, in our scheme, one that necessarily corresponds to some specific institutional description. Although the subject matter of this volume is institutional design, defining federalism in strictly institutional terms – in terms of, say, the allocation of jurisdictional responsibilities and notions of state sovereignty – places too great a constraint on design. Echoing the words of Ostrom (1991) that introduce this chapter, for us, ultimately, democratic federalism corresponds more to a process in which there is a continuous ebb and flow of authority among levels of government in accord with the preferences of its citizens and subject to the constraints of individual rights. Put differently, our concern here is that of describing institutions of self-governance that are self-sustaining, that ensure individual rights and the adaptation of those rights to varying circumstances, and that encourage those policy outcomes we ideally associate with a “well-functioning” federal state. Whether the institutions that are best suited to achieve these ends satisfy one definition of federalism or

<sup>7</sup> Later we argue that the mechanisms that encouraged the USSR’s seventy-plus years of survival paralleled those that encourage stability in any democratic federation, although they were not based on any system of formal constitutional incentives.

<sup>8</sup> For a full list of contemporary federal regimes, see Elazar (1994). Lemco (1991) provides a list of federal regimes that existed between 1579 and 1983.

<sup>9</sup> On the Spanish debates, see Hennessy (1989), Agranoff (1996), Solozabal (1996); the Italian debates are reviewed in Woods (1992); Newell (1998); Amoretti (2002). For an introduction to the issue of federalism in Ukraine, see Solchanyk (1994); Wolczuk (2002).

<sup>10</sup> For the discussion of the federal characteristics of the European Community/European Union, see Scharpf (1988); Brown-John (1995); Hesse and Wright (1996); Wincott (1996); Sbragia (1993); McKay (1996); Warleigh (1998); Abromeit (2002).



another is not our concern. Indeed, it may be the case that the theoretical prerequisites for achieving these ends will correspond to one person's definition only after we add to it some substantive constraints that apply to one polity but not another.

It is also possible, of course, that in the end, no definitive demarcation of our subject is possible and that we must instead accept the proposition that every unitary state has federal features and that every federal state can be described as a unitary whole along one or more descriptive dimensions. If this is the case – if, for instance, the local elections allowed in, say, Sweden open the door to the problems of federal design we describe here – the theory of democratic federalism we offer is simply more general than we otherwise suggest and applies to some degree to democracies universally. Indeed, given that the concept of federalism is not a theoretical primitive, we would be surprised if it were otherwise. For example, then, when we speak of a federal state “reverting” to a unitary form, we are not asserting that it has somehow been transformed into an entity about which we can say nothing, but only that it is now something that in some ways no longer meets the design criteria of those who sought to establish a state with certain minimal features of political decentralization and regional and local government autonomy.

### *Stability*

This volume also makes extensive use of the word “stable.” But as with “democracy” and “federation,” we suspect that no definition can be wholly satisfactory, nor can we assume that there exists a definition that allows for an unambiguous classification of states. For example, is Canada stable today, is Ethiopia stable despite Eritrea's secession, and is Britain stable despite Scotland's relatively successful push for greater autonomy? Should we deem Italy stable only as long as the Lega Lombardy fails to surpass some predefined threshold of electoral support? At what point between 1787 and 1860 did the United States become unstable, or is the fact of its civil war evidence that it was always unstable? Would we have labeled the USSR stable even as late as 1990? We cannot even say, then, that stability is akin to pornography – something we recognize when we see it. Stability for the Framers of the U.S. Constitution (or at least for Hamilton and Madison) required some permanence both to the law and in a state's “fundamental” institutions (Miller and Hammond 1989), and clearly by stability we mean continuity of those political processes we deem democratic.

But which institutions are “fundamental” and how much change can we admit in them and the law and still apply the label “stable”? The United States, for example, has undergone significant modification of its institutions, both formally and informally. Comparing the United States in 1800 (or even along some dimensions, 1865) with the country today, we find, among other institutional changes, at least the following: (1) direct election rather than appointment of senators; (2) the authority of the Supreme Court to rule

on the constitutionality of federal law and the consistency of state and local laws with the federal constitution and federal statutes; (3) uniform direct election rather than state legislative selection of presidential electors; (4) uniform application of single-mandate election districts for the U.S. Congress; (5) uniform application of the requirement of one man, one vote; (6) universal suffrage; (7) the establishment of a quasi-constitutional national bank explicitly entrusted with monetary stability; and (8) a national income tax. And to these changes we can add the emergence of a stable two-party system as well as an extensive list of federal and state regulatory incursions into the private sector. Although most of these changes occurred incrementally so that other components of the system were allowed to adjust to them, they nevertheless represent important modifications of the original federal design set forth in 1787. Despite this and with the sole exception of its Civil War (which, incidentally, was a period in which few of these changes occurred), it is hardly unreasonable to classify the United States as anything but a stable federation.

Nor can we define stability in terms of the relations between levels of government. In the United States, for example, how would we reconcile the attribution stable with the fact that in 1902 the ratio of national to state and local revenues was .6 and today stands at approximately 1.0, or that the ratio of local to national revenues stood at 1.3 in 1902 and today at .4? If money is the “mother’s milk of politics,” then mom’s identity has undergone significant change in this century. Although this change, like others, has occurred largely in an evolutionary way, few persons could object even today to Woodrow Wilson’s (1911: 173) conclusion that “the question of the relation of the States to the federal government is the cardinal question of our constitutional system. At every turn of our national development we have been brought face to face with it and no definition either of statesmen or judges has ever quieted or decided it. It cannot, indeed, be settled by one generation because it is a question of growth, and every successive stage of our political and economic development gives it a new aspect, makes it a new question.”

The notion of stability, then, along with that of an institutional equilibrium, must be treated cautiously and with the understanding that both allow for ongoing modifications in institutions and intergovernmental relations. Instead, to be judged stable a state must meet the minimal requirement of allowing change under preestablished rules – generally, constitutionally prescribed rules. But because even constitutions can be amended or supplanted according to established procedures, because secession may be constitutional, and because even a military junta can claim legitimacy as defender of a constitutional order, stability must, like federalism itself, remain an ill-defined and poorly measured concept. Somewhat vaguely, then, stability here will be taken to require a “relatively” peaceful, constitutional, and democratic adaptation of a political system to changing circumstances.

A state with an active and viable secessionist movement within it will not be deemed stable, nor will one that is subject to military usurpation of civil authority. But a state in which there is no sharp disruption of democratic process, in which politics is largely of secondary concern to most citizens, in which intergovernmental relations proceed and evolve according to constitutional rules, and in which the military remains subservient to civil authority will be deemed stable.<sup>11</sup> Stability, then, is an empirical dual of an institutional equilibrium whereby formal rules and individual motives generally and over time remain in agreement.

### *Institution*

The preceding definition requires at least one point of clarification – namely, what we mean by institution. Briefly, for purposes of this volume we will interpret institutions as “a set of rules that structure interactions among actors” (Knight 1992: 3). They may influence behavior by changing people’s expectations about the consequences of their actions, by changing their preferences over outcomes in some fundamental way, or by limiting or expanding their choices. Institutions, then, can correspond to a complex nexus of rules that we call a constitution, to a single rule we label a norm or law, or to the formalized framework of some organizational entity that defines a complete context of individual choice such as a legislature, a ministry, or bureaucracy.

To this definition we add one additional requirement: to be labeled an institution, the object must be directly manipulable, subject to conscious design, creation, modification, and even elimination. Thus, although a social norm such as those taught us by our parents may also be described as a “rule” that shapes preferences and action, and although both institutions and norms undergo evolutionary development, the things we label social norms generally fall outside of the scope of political institutional design. They, as part of the abstract thing we might call society’s culture and traditions, are best viewed as inputs to political design and constraints with which, if prudence is to dictate our choices, our institutions should not seek to violate.

Regardless of which definition or set of labels we employ, we cannot discuss and understand institutions without at the same time understanding the incentives they engender for individual action. To see what we mean,

<sup>11</sup> One can argue that no country fits this definition. Even if we ignore its civil war, we should not forget the discussion among radical Federalists in the early years of the American republic of the possibility of leading New England out of the Union in opposition to Jefferson’s Republicans, the Mormon Wars later in that century, bloody Kansas, the turmoil of third parties, and virtual military rule in the West. But we should not also lose sight of the extension of democratic institutions as territories moved to statehood. Our notion of stability, then, is more an ideal type – a design goal against which we judge the success of one design against another, even if it is not a goal that is ever wholly attained.

note that the political analysis of institutions typically proceeds by taking them as fixed constraints on people's actions, so that, for example, when studying elections we might take as fixed the requirements for being a voter or a candidate as well as the rules for aggregating votes that define winning. In this way, with specific assumptions about the preferences of the primary decision makers (e.g., the policy preferences of the electorate in combination with the assumption that participants labeled "candidates" prefer to "win"), we can try to deduce the strategies or choices of all participants and assess, for instance, the consequences of a plurality rule contest versus one that is held under majority rule with a runoff. However, this level of analysis, though necessary, is not sufficient for an understanding of the sources of such things as federal stability. The study of federalism is, of necessity, a macroanalysis of political systems, and as such we must also consider institutions that arise spontaneously as a product of other institutions and which, subsequently, either modify the impact of those prior institutional forms or supplant them altogether.<sup>12</sup> Indeed, as any student of politics and constitutionalism knows, few if any institutions are wholly immutable. Most, even under favorable and relatively unchanging circumstances, are difficult to treat as fixed and commanding universal compliance.

Given our earlier definition, these possibilities might lead us to ask whether something ought to be labeled an institution if it is mutable and a product of the choices it encourages. One can, of course, respond to such questions with the answer that any system of formalized rules can be labeled an institution even if it does not structure interaction in the intended way, structures interactions only weakly, or allows for its own evolutionary development. Nevertheless, such questions emphasize the practical fact that to understand an institution's full meaning we need to learn the incentives of people to abide by the rules and procedures that describe it, including their incentive to keep those rules and procedures in place. Suppose we learn in some specific context that, *ceteris paribus*, institution X is better suited to ensuring federal stability than institution Y. A mere description of X and Y, though, is of little practical value if there is nothing among the *ceteris paribus* conditions or among the motives X establishes that would keep relevant decision makers from subverting those rules or substituting a different set altogether. Thus, although it is tempting to attribute Switzerland's highly decentralized form of federalism to its system of referenda and the multiple opportunities for different sets of political actors to veto change, we cannot, without further argument, give such "explanations" the status of fundamental (necessary and sufficient) cause until we also understand how and why these institutional constraints are sustained.

<sup>12</sup> For an elaboration of the idea of the spontaneously generated institution set in the context of constitutional choice and endogenous enforcement, see Voigt (1999).