The idea of improving America’s public sector by shifting resources and authority to lower levels of government has tremendous intuitive appeal, particularly when so many citizens view government as alien, unaccountable, and inefficient. Competition among rival jurisdictions promises to wring out waste and tighten management by forcing officials to respond to citizens’ priorities and deliver more value for taxpayers’ money. Decentralization and interjurisdictional mobility gives the individual power over government that can be exercised on the citizens’ terms, at the citizens’ own initiative, at any time. If public authority is pushed down to levels where choice and competition can operate, every citizen can stage a personal revolution armed with only a moving van.

The proposition that over-centralization is a substantial element of what ails American government, and devolution to the states a potent corrective, inspires periodic calls for a “new federalism” to bolster the role of the separate states and constrict Washington’s domain. These proposals—including partly overlapping policy initiatives from the Nixon and Reagan administrations, and more recently from an uneasy alliance of Republican legislators and executive-branch Democrats—have had some success. Over the last few decades, the trend has been mildly toward decentralization within overall public spending, and strongly so within the narrower category of domestic governmental operations (excluding transfers and debt service). Since 1970, total spending by all levels of government has wandered within the fairly narrow range of 27 to 32 percent of gross domestic product; in 1996, it was 29.6 percent (Office of Management and Budget, 1997, 1998).

John D. Donahue is Associate Professor of Public Policy, John F. Kennedy School of Government, Harvard University, Cambridge, Massachusetts. His e-mail address is jack_donahue@harvard.edu.
table 15.3). But there have been striking changes in composition. The sum of all federal spending other than defense, interest, and transfers dropped from 4.2 percent of GDP in 1980 to just 1.7 percent in 1996. Over the same period, state and local spending funded by state and local tax revenues has grown from 8.5 percent to 10.3 percent of GDP. (This actually understates the share of public expenditure under subnational control; roughly one-fifth of state and local spending is covered not by subnational revenues but by federal grants. Meanwhile, the state share of the state-local total has been growing as well.) Expenditure is not the only metric of relative importance, to be sure, but other gauges—like Supreme Court decisions augmenting state autonomy and popular support as signaled in opinion polls—also mark a trend away from Washington.

Government weighted toward the separate states has important generic advantages, many of which Inman and Rubinfeld perceptively detail in their contribution to this symposium. Diverse policy regimes can cater to heterogeneous preferences and accommodate varying conditions. Collective choices are less error-prone, and public administration less plagued by agency problems, with a smaller polity and simpler policy agenda. Interstate competition can discipline government, augmenting the "voice" of the ballot box with the "exit" of mobility. Centralization has its characteristic virtues as well. Costs and benefits falling beyond state borders can be incorporated into policy decisions without interjurisdictional negotiation. There is greater potential for risk spreading and redistribution. Scale and scope bolster bargaining leverage with external actors.

While the optimal degree of centralization yielded by balancing such factors will vary from issue to issue and from period to period, both scholarly and popular commentary increasingly lean toward decentralization. My goal in this comment is to raise some doubts about this intellectual vogue—and the real-world trends it is helping to propel—and to suggest that at America's current margin of public-sector centralization, the disadvantages of a further shift toward state-centered government are likely to outweigh the advantages.

**The Market Metaphor**

The basic theme of governmental competition as a check on official power is neither new nor restricted to economics. It is central to the U.S. Constitution, and figures explicitly in the political rhetoric promoting that charter's ratification. When economists invoke consumer choice among rival purveyors as a metaphor for improving government through decentralization and competition, however, they usually begin with Tiebout's (1956) brief essay, which is among the most-cited publications in economics. A vast chorus echoes this theme. The Advisory Commission on Intergovernmental Relations (1991, p. 4) declares, "Just as market competition produces an economic system responsive to consumer needs, interjurisdictional competition can produce a government system responsive to voter desires." The authors of one public finance textbook take it as axiomatic that in-
terjurisdictional competition "is a spur to efficiency because it forces government officials to keep benefits in line with taxes paid" (Browning and Browning, 1983, p. 469). Similar sentiments could be cited almost endlessly.

Every economist appreciates, however, that even in the private sector—the home turf of the efficient competition model—the textbook ideal of perfect competition is only a rough approximation of reality, and the merits of market rivalry are contingent on a well-known set of conditions (Scherer and Ross, 1990, p. 18). In this tradition, Tiebout (1956) was scrupulous about listing the conditions under which the potential benefits of jurisdictional competition would be realized.

The conditions hold well enough, for a wide enough range of transactions, to amply justify popular and scholarly enthusiasm for market competition. But extending the logic to government competition requires far more intrepid conceptual leaps. For example, all but a few private markets display an ease of entry and exit that all but a few governmental settings conspicuously lack. If forming and maintaining polities were costless, it would be silly to restrict ourselves to the meager jurisdictional menu of nation, state, and city (Scharpf, 1976, p. 28; Breton and Scott, 1978, pp. 37–39; Tullock, 1969, p. 27; Olson, 1969). In principle, a custom-tailored government should be matched to each collective purpose. But the cost of forming, maintaining, and restructuring polities is often high, and governmental mergers, spin-offs, and liquidations tend to be more traumatic transactions than their private sector analogues. Thus the number and configuration of public sector entities have more to do with the accidents of a capricious history than with the shifting dictates of economic rationality.

The remainder of this comment will take up three more general grounds for hesitation about applying the market metaphor to America's devolution debate.

The Case for Collusion

Market competition both curbs waste (augmenting the total surplus) and tilts that surplus toward purchasers. Only in the most exotic cases can business collusion benefit the average individual. But (except for those who see public institutions as irredeemably wasteful) there is often a reasonable case for governmental collusion.

Consider state efforts to attract mobile business. While such efforts form a perennial theme of American economic history, there is evidence of an intensification in interstate competition for investment since, roughly, the mid-1970s (Chi and Leatherby, 1997; Koropeckyj, 1996; KPMG Peat Marwick, 1995, p. 5). The history of nine major automobile-plant deals, for example, traces the progressive transfer of rents from states and cities to Japanese and European automakers as subsidy packages rose from roughly $4,000 per job for Honda's 1980 investment in Ohio, to roughly $168,000 per job when Daimler Benz selected Alabama after a 30-state bidding war.¹

¹ These are very coarse figures, unadjusted for the time value of money and based on shaky employment projections, but the trend is clear.
Given a competitive setting, it can be entirely rational for states to bid aggressively for major investments offering good jobs. The consequences, however, include higher taxes and shrunken spending for other constituents and a disproportionate solicitude for the more mobile kinds of business. The demonstrated fragility of interstate compacts to curb such competition (due to classic prisoner's dilemma dynamics) shows the difficulty of engineering collusion, but doesn't disprove its desirability. As Graham and Krugman (1989, p. 119) observe, "States would be well served if their power to grant investment incentives were simply abolished." Indeed, there are periodic calls for federal measures to enforce interstate collusion, although the political and practical impediments are formidable.

A comparable collective-action problem arises in a quite different policy area—the regulation of gambling. As recently as 1988, Nevada and New Jersey were alone in allowing casino gambling; eight years later there were 500 casinos operating in 27 states, and some form of gambling was legal in all but two states. Gambling's migration from the margins to the mainstream, one of the more notable economic and social developments of the past decade, is almost wholly the product of changes in state law. Permissive state rules on gambling gratify those who deplore paternalism, and also bring obvious benefits to the state that runs the lottery or hosts the casinos, including relatively high-paying unskilled jobs and revenues for the state treasury. But there are costs as well. Access to legal gambling has been found to increase the number of people who develop a gambling problem, with consequences ranging from mild economic inconvenience to bankruptcy, embezzlement, divorce and suicide. More generally, some see gambling as immoral, or corrosive of the work ethic.

The real question is whether the wholesale liberalization of gambling laws reflects popular judgments about the proper balance of these factors. The logic of interstate competition suggests some cause for doubt on this score. If a state loosens its own restrictions on gambling, it gains the benefits in jobs and tax revenues. It also suffers costs—but not all the costs. When citizens of other states buy the lottery tickets and visit the casinos, they leave their money behind when they return home, but take their gambling-related problems back with them. Conversely, states that retain restrictions on gambling will share in the costs as their citizens gamble out of state, but will not receive any of the benefits, and may rationally liberalize their laws in turn. Permissive gambling legislation in Iowa and Wisconsin was aimed at attracting citizens from the Chicago area; Illinois responded by loosening its own laws (Johnson, 1995; Goodman, 1995). New York's governor, calling for laxer gambling laws, emphasized "the most important thing is to be able to stop losing billions

\[\text{\textsuperscript{2}}\text{A similar problem was faced in the 1780s as state after state—hoping to channel commerce through its own ports—bypassed the national government to strike its own trade agreements with Great Britain. This led Alexander Hamilton (1961, pp. 91) to argue in Federalist 11 for centralized trade policy. He wrote: 'Let the thirteen States, bound together in a strict and indissoluble Union, concur in erecting one great American system superior to the control of all transatlantic force or influence and able and able to dictate the terms of the connection between the old and the new world!'\]
of dollars to surrounding states” (Hernandez, 1996). A lobbying firm promoting casino gambling in Florida found that survey responses flipped from majority-opposition to majority-support when a question was reframed to emphasize that gambling was already widespread in the region, so that voting down legalization would only make Florida “miss out on the revenue and economic development casinos generate.” The equilibrium under interstate competition, in short, may feature more liberal gambling laws than the average citizen would prefer.

**Heterogeneous Mobility and “Citizen’s Surplus”**

The market metaphor for governmental efficiency requires that location choices respond to state policies. What might be called the “elasticity of location” for individuals and institutions with respect to taxes, public services, and regulatory regimes must be sufficiently high, for a sufficiently large fraction of constituents, to motivate government officials, whether directly or indirectly.

This elasticity varies widely among constituents. For individuals, the rate of interstate migration in the postwar era has usually been in the range of 3.0–3.5 percent per year, dropping to below 3 percent throughout the 1990s (U.S. Bureau of the Census, website). In principle, such rates could still be high enough to affect policy deliberations. A 3 percent average rate could mask much higher inflows into well-run states and away from inefficient governments. Or it could be an equilibrium figure, reflecting the discipline imposed on state governments by much larger numbers poised to move if their state departs from the preferred tax and service portfolio.

But individuals typically make their interstate migration decisions for reasons that have little or nothing to do with the performance of current officeholders. In part, this is because most state policy decisions have indirect and lagged effects on the average citizen’s welfare. But more fundamental is the fact that individuals enjoy a large “citizen’s surplus”—analogous to the “consumer’s surplus” of valuation in excess of the price paid in private exchanges—composed of cultural affinities, ties to friends and family, and economic connections. In most cases, the quality of state government could deteriorate sharply, in terms of the portfolio of policies offered or the efficiency with which they are delivered relative to alternatives in other states, before a citizen’s locational surplus is whittled away and migration becomes rational.

Business, educational, and other institutions lack the personal dimensions of citizen’s surplus, but vary widely in the other factors that condition their locational elasticity with respect to state policies. Some institutions are powerfully anchored by investments in a current locale or by location-specific access to inputs or markets. But as transport and communication costs fall, states are becoming increasingly close substitutes for the purposes of the typical economic institution. While the issue remains controversial, the weight of state policy in industry location decisions does appear to be rising (Donahue, 1997, Appendix.)
This heterogeneity of locational elasticity with respect to state policy has several implications. First, the promised efficiency benefits of interjurisdictional competition are more likely to be found at the local level, where migration is much more common and usually requires surrendering less surplus. Second, migration is a far more credible response to state policies for most institutions, and for a subset of individuals whose "citizen's surplus" is a particularly light counterweight to state policies. But those at the margin of migration may be quite different from the median citizen. For example, retirees with substantial financial assets may have earnings that are invariant with respect to location and relatively light family burdens, while their expected after-tax wealth may be strongly affected by state taxation of capital income or estates, making them differentially ready to incorporate state policies into their location decisions. Evidence from Australia and the United States is consistent with this conjecture (Grossman, 1990; Cebula, 1990; Hansen, 1995, table 16). Loners, the childless, divorced non-custodial parents, and those with too many or too few economic resources to be much concerned about established careers may also have a smaller-than-average citizen's surplus. It is not obvious that the signals sent by the migration of such constituents will provide the right incentives to state officials from the perspective of the population as a whole.

A general implication is that as state government grows more important within America's public sector and interstate competition intensifies, policies can be expected to evolve to favor constituencies that are more mobile and more desirable, at the expense of constituencies that are less mobile and less desirable. Taken to the limit, as Oates and Schwab (1991, pp. 140–141) write, "[T]he outcome under interjurisdictional competition is identical to the outcome that would emerge if one were to replace local governments with perfectly competitive firms that supplied local public goods to firms and households at marginal cost." By some measures, of course, such an arrangement is highly efficient, but the implied transformation in what we mean by governmental accountability may warrant broader debate than it has so far received.

Distribution, Income Inequality and Welfare Reform

Theorists from Tiebout (1956) onward have conditioned their predictions of efficiency gains through intergovernmental competition on the pre-existence of an optimal income distribution, or on the existence of an overarching level of government responsible for redistribution. The distributional perspective highlights two remarkable things about the shift toward the states. First, it coincides with sharply rising wage inequality (as discussed in a symposium in the Spring 1997 issue of this journal). Second, it has been pushed farthest and fastest in anti-poverty policy, rather than in areas less freighted with distributional issues, like criminal justice or infrastructure finance.

The effects of the Personal Responsibility and Work Opportunities Reconciliation Act of 1996 will remain a matter of conjecture for some time to come. It is
difficult to defend the pre-reform welfare system, or to deny the potential gains from experimentation, innovation, and tailoring programs to fit state-specific conditions and priorities. And it is conceivable that the new arrangements will perform as advertised, even after the next recession tightens state budgets and makes it harder to put former recipients into private-sector jobs. But the post-reform system also features built-in incentives for state austerity (Blank, 1996).

Despite long-standing predictions of competitive benefit cuts by states anxious to avoid attracting the dependency-prone, previous studies have found limited evidence of a “welfare magnet” effect that would drive a “race to the bottom” (Brown and Oates, 1987; Levine and Zimmerman, 1995; Gramlich and Laren, 1984). But this research scanned a world with a federal floor under benefits and (more important) a large federal share in the marginal welfare dollar. In that context, neither beneficiaries nor state officials had strong incentives to pursue the strategies triggering a race to the bottom. As new policies alter incentives, warnings of such a race may well turn out to have been (in a precise sense of the term) premature.

Inman and Rubinfeld’s essay stumbles somewhat on this point. They describe welfare reform’s partly offsetting provisions of a “price effect” sharply raising the real cost to the state of each dollar spent on welfare as federal matching is abolished, and an “income effect” of block grants that exceed for most states the sums they would have received under the prior regime through 2002. But the price effect is permanent, and the income effect is transitory. Block grants from 2002 onward will be set at whatever level future Congresses decide, and it seems less than likely that in the early years of the next century—as federal budget constraints tighten and after anti-poverty policy has been declared the states’ domain—Congress will be eager to ease the governors’ welfare problems through comparably generous transfers.

Rendering the poor immobile across states can defuse the race-to-the-bottom scenario, as has long been recognized. The nineteenth-century English poor laws restricted the poor to their home parishes (Polanyi, 1944; Stewart, 1985), and America’s pre-constitutional Articles of Confederation specifically excluded “paupers” from the provision that “the people of each state shall have free ingress and regress to and from any other state” (Morison, 1923, p. 178). The 1996 legislation does give states some tools to deter the immigration of the poor—notably the option to limit newly-arrived residents to the benefits they would have received in their previous state, for up to one year—but the durability of this bulwark remains to be tested in practice, and its constitutionality remains to be tested by the courts.³

Skepticism about the net improvements to be anticipated from increased interstate competition does not mean dismissing the role of rivalry in enforcing ac-

³ Under the prior welfare system, the courts had barred differential treatment of citizens newly arrived from other states as a barrier to citizens’ mobility; it is unclear whether this standard will hold as welfare loses its status as an entitlement. I am grateful to Mary Jo Bane for information on this issue. Relevant court cases are Shapiro v. Thompson (394 U.S. 618 [1969]) and Memorial Hospital v. Maricopa County (415 U.S. 250 [1974]). (The first court case, in October 1997, ruled Pennsylvania’s efforts to deter welfare immigration unconstitutional.)
countability on public officials. Rather, it reflects doubt that interstate competition for constituents is a superior alternative—or even on balance a beneficial adjunct—to intrastate competition for electoral support. The diffusion of governmental innovations, for example, appears to be driven by rivalry among current and aspiring officials to present voters with new ideas (Walter, 1969, p. 890; Carpenter, 1991), rather than by interstate rivalry for constituents. The efficiency benefits for most Americans from elevating "exit" over "voice" as a device for disciplining government are likely to be smaller than they at first appear to be, while the depressing effect on public-sector capabilities may prove graver and more general. In other settings, with weaker constraints on governmental opportunism, the calculus may well differ. (For example, Qian and Weingast discuss the case of China in this symposium.)

Some observers applaud virtually any measures to augment choice and enfeeble government even in the contemporary American context, and from such a perspective, enthusiasm for devolution is well-founded. But for those who retain a measure of faith in the possibilities of collective action, there are severe limits to the market metaphor's applicability to the problems of American government.

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