

CITIZENS AND CONSUMERS:  
FEDERALISM BETWEEN POLITICS AND MARKETS

**Speech delivered at the Institute of United States Studies, London  
January 29, 2002**

Michael S. Greve  
John G. Searle Scholar  
American Enterprise Institute

**Markets and Democracy**

Christianity, G.K. Chesterton observed, appeals to individuals who appreciate paradoxes. Something similar might be said of federalism. Federalism entrusts different levels of government—one partially subordinate to the other—with authority over the same citizens, territory, and transactions. Federalism insists on this arrangement as a means of protecting liberty. It insists, in other words, that the best way to have less government is to have more governments.

Federalism also insists on a sphere of political autonomy and independence of the member-states (or countries). Decentralized political control is believed to promote opportunities for citizenship and civic engagement in political institutions that are “closer to the people” than the distant national government. At the same time, though, federalism limits the range within which member-states may assert their democratic will. One set of such constraints consists of shared civil rights. Another set of restraints flows from the commitment—common to all federalisms that are worth having—to a common economic market among the member-states, unimpeded by state protectionism and discrimination. The conflict plays only a small role in highly centralized federal systems, such as

Germany's. But it continues to be a salient issue in the United States. For example, the billion-dollar tort verdicts about which you may have read (and no doubt have shaken your heads) are the products of our state-based tort system. The question of whether these exercises of state autonomy should be regulated at the national level, in the interest of protecting interstate commerce, is the subject of a long-running, acrimonious debate.

The tension between common markets and decentralized political self-determination characterizes not only federal systems. It characterizes all political arrangements that attempt to marry the two objectives, from free-trade pacts such as the World Trade Organization (WTO) to confederacies such as the European Union. All of them confront the member states with the problem of reconciling free trade and political decentralization, markets and politics, consumer welfare and democracy close to home.

In observing this commonality, I do not mean to slight to difference between federal systems of government and confederations, let alone looser treaty alliances. Federalism is a government over citizens; a confederation is a government over governments. That difference matters, as is illustrated by the incipient but already fierce debate over the European Union's contemplated transformation from confederacy to federalism. I will have something to say on federalism towards the end of my talk. My starting point, though, is the broader conflict between common markets and democratic rule under all governmental arrangements that seek to harmonize the two objectives.

The tension between markets and democracy defines a fundamental political divide. With a handful of exceptions such as Argentina, which is seceding from the world economy to spend more quality time with itself, countries around the world have recognized the benefits of free trade. That recognition has led to the creation of the WTO

and, on a regional (but continental) scale, of NAFTA, Mercosur, and the European Union. But these arrangements have met with increasingly potent opposition. Politicians and intellectuals of a social-democratic or, as we say in the United States, a liberal persuasion object to free trade agreements, and the point of their attack is precisely that such agreements represent a triumph of markets over democratic citizenship. That objection is the central point of the attacks in the United States against NAFTA and the WTO. The European Left likewise insists on the primacy of politics over markets, though not with an isolationist but an internationalist bent: political control over private markets is the central point of the push for a democratic, federal European Constitution that will move the Union beyond a “mere” common market.

This “democracy argument” against common markets bears a superficial affinity to the wailing and rock-throwing against global capitalism and exploitation. Unlike those rants, however, the democracy argument is intellectually respectable. Moreover, it has considerable political force—first, because it coincides with the interests of powerful domestic constituencies (such as trade unions); second, because it resonates with conservatives who, though supportive of free trade, fear the transfer of national sovereignty and self-determination to international organizations.

One could argue, of course, that common-market agreements present no conflict at all with democracy at home. Democratic countries that join a treaty, confederation, or federal republic thereby consent to the attendant constraints on their sovereignty. That observation, though, raises the further question of whether countries *should* agree to such bargains and, if so, on what conditions. Nor is it entirely satisfactory to insist on the great economic advantages of free trade arrangements. In a contest between GNP growth and

democracy, growth will often lose. I therefore wish to explore a third reply: in important respects, the discipline of common and free markets improves, even while it constrains, the exercise of democracy at home. Free markets compel governments to compete for mobile citizens and businesses. Exposure to competition does not render democracies more “democratic.” It does, however, tend to make them more transparent and deliberative—more republican, to use an old-fashioned term.

To my mind, this argument has considerable intellectual merit. The question of whether it has any political purchase may warrant a different, more pessimistic answer.

### **The Economists’ Vision: Competition Among Governments**

All economists favor free trade and common markets. Most economists also favor political decentralization. That is because economists view government as a monopoly problem. To be sure, we *need* government to procure public goods, such as police protection, on a monopolistic basis. But that does not make the usual monopoly problems—coercion, exploitation, economic rents—go away. Democratic control, even when exercised under constitutional constraints, is only a partial solution to this problem, since democratic majorities may easily become elective tyrannies.

A complementary solution to the monopoly problem is to institutionalize competition among governments. Competition among independent governments gives citizens a choice between different (local) monopolies and allows them to move to a jurisdiction of their taste. Citizens choose, like consumers, among various packages of government services in different locales. The prospect of losing productive citizens and businesses to more appealing jurisdictions will discipline governments and compel them

to produce more value for their citizen-shareholders, at a lower price. This economic model of government competition is sometimes called the “Tiebout model,” after the eponymous author of a ground-breaking article that, since its publication almost half a century ago, has generated an enormous literature on the virtues and problems of competition among governments.<sup>1</sup>

In some sense, of course, every government faces competition—unless it is alone in the world or else, willing to imprison its citizens. But governments can compete in more than one way. They can compete, for example, through protectionism and—to quote James Madison—through “rival and spiteful measures” to the detriment of other states and their citizens. That, obviously, is not the competition the economists have in mind. Their idea, rather, implies free commerce across borders. Citizens choose their state, not the other way around.

Competition in this sense requires rules and institutions, which economists discuss under the heading of “competitive federalism” or, more awkwardly, “market-preserving federalism.”<sup>2</sup> The general model and its logic apply not only to full-fledged federalism but also to looser forms of institutionalized competition among governments, such as free-trade pacts. All such arrangements can be understood as attempts to mimic, in politics, the virtues of private markets—competition, choice, innovation, better products at lower prices.

All such arrangements, too, limit the exercise of democratic sovereignty by and within the competing jurisdictions. First, efficient competition requires direct restrictions

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<sup>1</sup> Charles Tiebout, *A Pure Theory of Local Expenditure*, 64 J. POL. ECON. 416 (1956).

<sup>2</sup> [cite Kincaid, Weingast, et al.]

on the kinds of laws the member-jurisdictions are permitted to enact. Second, competition among governments subjects voters and their elected representatives to pressures, motivations, and incentives that differ greatly from those that operate on the rulers and citizens of an autarky. Third, just as competition in private markets depends on adjudicatory institutions and enforcement mechanisms to protect the “rules of the game,” so competition among governments require at least some supra-national (or supra-state) institutions.

***Direct Restraints.*** Efficient competition among governments, as just noted, presupposes mobility and free commerce across borders. Free trade, in turn—Europe’s famous “four freedoms”—requires explicit prohibitions against state protectionism and, more broadly, a general commitment to non-discrimination among citizens and outsiders. Ground rules against exclusion and discrimination are the basic stuff of trade agreements, such as the WTO; of confederacies and alliances such as the European Union, where the guarantees are contained in the European treaties; and of federal constitutions. The United States Constitution contains several provisions that explicitly prohibit certain forms of state protectionism, while mandating that states must extend equal rights, privileges, and immunities to citizens and non-citizens. (Virginia may not have one rule for her own citizens and another one for New Yorkers.)

Efficient competition among governments may require additional rules, such as a prohibition against policies that impose significant costs on competing sister-states. But even the minimum rules are anything but trivial. Excluding foreigners and treating citizens better than anyone else is what sovereign states do, and a state that agrees to

surrender its right to exclude and discriminate has surrendered a piece of its sovereignty. Its citizens and politicians may no longer do what comes most naturally, which is to exercise democratically constituted government power for their own benefit, to the detriment of outsiders.

***Incentives.*** Competition among governments requires one (but only one) fundamental civil right—the right to exit or, as the common phrase has it, the citizens’ right to “vote with their feet” (or pocketbooks, or modems). That possibility of exit of course confronts all countries other than those that imprison their subjects. But the force of the exit right depends on the costs of exercising it, and those costs drop as other countries (where I might wish to live and work) agree to let me in. In that sense, competitive regimes institutionalize exit rights.

Powerful exit rights, in turn, change the calculus of domestic coalitions, interests, and politicians. If country A were alone in the world, its citizens might choose to protect the environment at level (and cost) “X”; the possibility that such regulation might prompt productive enterprises to depart might induce citizens to choose “X minus 10.” The intensity and the benefits of this effect are a matter of considerable uncertainty and dispute. The tendency of the effect, however, is undisputed. Generally speaking, the effect is most severe with respect to redistributive policies that take from A to B: since the losers under such schemes get nothing in return for their contribution, they have a powerful incentive to escape. This is why political forces whose agenda rests on redistribution (such as trade unions) tend to oppose free trade pacts and, in a domestic context, federalism.

*Supranational Institutions.* Some forms of institutionalized competition among governments require little or no continuous enforcement or adjudication. A simple reciprocity agreement (“you let in my citizens, and I let in yours”) is an example: so long as both parties consider the agreement advantageous, it will enforce itself. That is not true, though, of firmer or more ambitious arrangements.

The need for on-going adjudication and enforcement arises because the competitive “ground rules” are subject to interpretation—and because member-states have a persistent urge to evade them. For example, states may not discriminate against foreign producers by subjecting them to higher taxation than domestic industries: does that prohibition also apply to targeted subsidies for domestic producers? Outright tariff barriers, for another example, are prohibited: does that prohibition extend to domestic laws (such as public health or environmental standards) that have the practical effect of a tariff? Since every member-country will attempt to circumvent the competitive ground rules so as gain advantages for domestic constituencies, such questions will arise frequently. Binding interpretations of the competitive ground rules that forbid this or that evasive maneuver will generate yet more clever schemes, necessitating another round of central enforcement.

The American founders anticipated this difficulty, and they provided the courts and the United States Congress with the means of suppressing the states’ factious and protectionist tendencies. But looser competitive arrangements among independent countries also require some central institutions to resolve disputes. The WTO has adjudicatory institutions and enforcement mechanisms. The EU has what by now looks



very much like a confederate government. The greater the authority of the central authority, the more limited the realm for domestic politics and democratic participation.

Clearly, then, competition among governments entails political costs to (local) democratic control. These costs do not appear in the economists' model, which typically exclude anything that smacks of politics. The original Tiebout model precludes the competing local governments from learning from, or adapting to, citizen exit or influx. More refined models, with a more Hayekian twist, allow and in fact emphasize institutional learning, but the literature on how, when, and under what conditions governments learn from competition is very thin. (Some seem to learn next to nothing. In some three decades, for example, New York City has lost most of the Fortune 500 companies once headquartered there without adjusting the tax and regulatory burdens that have induced the exodus.) "Market-preserving federalism" fails to tell us whether the formal model is sustainable under realistic political conditions. One learns from the economic literature a great deal about the potential economic costs and benefits of competition—and nothing about citizenship and democracy.<sup>3</sup>

### Politics

The political deficit of economic theory, and the political costs of national and international competition for mobile capital, goods, services, and citizens, animate the

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<sup>3</sup> For critiques of the Tiebout model along these lines see Dennis Epple & Alan Zelenitz, *The Implications of Competition Among Jurisdictions: Does Tiebout Need Politics?* 89 J. POL. ECON. 1197 (1981); and Henri I. T. Tjoing, *Breaking the Spell of Regulatory Competition: Reframing the Problem of Regulatory Exit* (2000) (available at [http://www.papers.ssrn.com/paper.taf?abstract\\_id=267744](http://www.papers.ssrn.com/paper.taf?abstract_id=267744)). Jonathan Rodden and Susan Rose-Ackerman, *Does Federalism Preserve Markets?* 83 VA L. REV. 1521 (1997) argue that formal models of market-preserving federalism are politically unsustainable except under highly unusual political conditions.

basis of the political opposition to arrangements that institutionalize such competition. In the United States, left-wing constituencies (such as trade unions, environmental groups, consumer advocacy organizations, and trial lawyers) united with protectionist forces on the right (such as textile industries and Patrick Buchanan's populist constituencies) in opposing NAFTA and the WTO. In Europe, the moderate political Left has zeroed in on the democracy argument as its weapon of choice in advocating a democratic, federal Europe over a mere common market.

Naturally, the democracy argument is often commingled with more direct claims about the supposedly dire effects of international trade and competition on domestic jobs, environmental protections, and the like. But if the foes of government competition were concerned only about the economic effects on particular constituencies, they could simply insist on devoting a portion of the enormous gains from free trade to compensating the losers. The fears and objections that have been voiced against free trade agreements go much beyond their immediate economic effects; they concern the broader effects of international competition on domestic democratic institutions. The democracy argument is more than parochialism in drag.

An unvarnished, forceful presentation of the argument is a much-noted, June 2001 speech on the need for a European Constitution by the eminent German philosopher and sociologist Juergen Habermas. Echoing sentiments and arguments voiced by Lionel Jospin and Joschka Fischer, whom he rightly credits with having shaped the agenda for a European Constitution, Habermas takes aim at the project of the Union as a mere common market. That construct, he avers, implies a notion of individuals as "rationally deciding entrepreneurs who exploit their own labor." Its ideal is a "post-egalitarian

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society that tolerates marginalization” and the “exclusion” of the less fortunate. An economic union reduces citizens to “members of a market society” and the state, to “a service institution for clients and customers.” It implies a politics that pretty much “takes care of itself,” as distinct from an energetic, participatory enterprise.<sup>4</sup>

That indictment might entail a call for an end to the preoccupation with a common market—for more subsidiarity and democratic citizenship closer to home. Habermas, however, makes the opposite move. The European Union, he argues, must construct a European society of citizens, a pan-European “public sphere,” and a shared European political culture—not as a complementary step after economic liberalization, but precisely to confine economic markets, competition and choice to a subordinate sphere. That, in a nutshell, is the point and purpose of a European Constitution.

Even in its existing form, of course, the European Union embodies Habermas’s premises—the “building blocks of a neo-liberal world view,” as he calls them—only very imperfectly. A union constructed entirely from those blocks, for example, would feature virtually none of the EC’s elaborate harmonization proceedings: it would mandate open borders and reciprocity among the member-states, and be done with it. That said, Habermas indictment of “neoliberal” competition in government is, in an analytical sense, exactly right. The competitive model does indeed conceive of individuals as autonomous producers and as consumers of “law as a product.” Competition does

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<sup>4</sup> Juergen Habermas, “Warum braucht Europa eine Verfassung?” The speech, originally delivered at the University of Hamburg and subsequently published in *Die Zeit*, is available at [www.zeit.de/2001/27/Politik/200127\\_verfassung.html](http://www.zeit.de/2001/27/Politik/200127_verfassung.html). The quotations in the text are my translations. Monsieur Jospin and Herr Fischer have advocated a European constitution for reasons very similar to those urged by Habermas. See Lionel Jospin, “What Are Our Ambitions for the European Model of Society?” (May 28, 2001) (available at [www.info-france-usa.org/news/statmnts/jospin/jospeuro.asp](http://www.info-france-usa.org/news/statmnts/jospin/jospeuro.asp); and Joschka Fischer, “From Confederacy to Federalism—Thoughts on the Finality of European Integration” (May 12, 2000) (available at [www.jeanmonnet-program.org/papers/00/symp.html](http://www.jeanmonnet-program.org/papers/00/symp.html)).

constrain government-engineered redistribution to the less fortunate (and everybody else). The economists' model does embody a reductionist notion of politics, for it is entirely focused on governments' output of services. How that output is produced is irrelevant, or nearly so.

The serious objection to Habermas and his fellow-Europeanists is that the relation between neoliberal premises and democratic citizenship is more complicated than their simple dichotomy suggests. Competition among governments, according to Habermas, represents a triumph of markets over politics. Democratic politics is invariably the loser. That claim, however, is belied by a great deal of evidence.

Capitalism, by way of a well-known macro-historical example, was the product of competition among rival authorities (especially church and state) in Europe. Countries that were exposed to competition experienced not only stupendous growth but also the rise of liberal democracy. Countries that chose isolation (such as China) experienced sustained poverty—and tyranny.<sup>5</sup> The competing countries had to extend civic rights and democratic participation to the productive classes—traders and merchants first, then the bourgeoisie, then workers. There is no straight line from competition to capitalism to democracy (or, as social scientists say, “modernization”); what I have just sketched is an extremely crude summary of a complicated argument. But at least at a general level, there appears to be a strong correlation between government competition and democracy. Democratic citizenship today is doing much better in countries that open themselves to

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<sup>5</sup> Jurisdictional competition is the most compelling explanation of why capitalism developed in Europe but, for a considerable length of time, nowhere else. *See* DOUGLASS C. NORTH & ROBERT P. THOMAS, *THE RISE OF THE WESTERN WORLD* (1973); ERIC L. JONES, *THE EUROPEAN MIRACLE* (2<sup>nd</sup> ed. 1988); DAVID S. LANDES, *THE WEALTH AND POVERTY OF NATIONS* (1999); ANGUS MADDISON, *THE WORLD ECONOMY: A MILLENNIAL PERSPECTIVE* (2001).

international markets than in those that do not, and secession from those markets invariably entails highly repressive policies.

It is possible that the relation between competition and democratic citizenship is an inverted U-curve. Competition may help to democratize nations; once nations *are* democratic, institutionalized government competition reduces the range of objectives that national politics may or can hope to attain, and the curve slopes downward. More competition means less democratic self-determination.

That might be true, and might even be unambiguously true, if all were in good order with the actual operation of democracy—if democracies weren't in need of discipline and correctives. All is not well, however, with democratic citizenship in Western democracies. Moreover, the problems attendant to mass democracy cannot be remedied by democratic means. Competition, in contrast, supplies a cure—not a cure-all, but a cure. Competition can serve as an auxiliary precaution and a partial remedy to the problems most incident to democratic government.

### **Democracy's Discontents**

Most advanced democracies report high levels of public distrust of government. Public confidence in Washington, D.C. fell below 50 percent in the early 1970s and has remained below that level ever since. Roughly half of the EU voters are dissatisfied with the way democracy works in their own country. All major European countries except the United Kingdom approximate or exceed that average; Italy takes the cake with a 76 percent dissatisfaction rating. Only in Denmark and Luxemburg does the percentage of “very satisfied” voters exceed 10 percent.

The numbers do of course fluctuate with current events in individual countries, and the sources of dissatisfaction quite probably vary from country to country and from time to time. The symptoms of civic alienation also vary (fragmentation of the party system in Germany and Austria, declining voter participation in the United States). But the level of dissatisfaction is consistently and distressingly high, and it appears to have risen in tandem with the expansion of the state and its functions. Governments are viewed as being distant, run by special interests and unaccountable bureaucrats, and in some sense beyond the public's control. Citizens feel—or at least tell the pollsters—that their voices and votes do not matter.

These sentiments mirror a pervasive phenomenon that political scientists have described under varying labels—“ungovernability,” “*Politikverflechtung*,” “ossification,” “(Euro-)Sclerosis.” One such account, the late Mancur Olson's theory of democratic sclerosis, rests on minimalist assumptions that should be broadly acceptable. First, the theory assumes “rational ignorance”: in light of the costs of being fully informed of public affairs, voters will reasonable choose to be less than fully informed. Second, the theory rests on the logic of concentrated benefits and dispersed costs. Under conditions of imperfect information, the beneficiaries of government programs will know a lot about, and lobby for, their benefits. The voters at large will both know and care less. Thus, democracies will tend to enact programs that benefit minorities so long as the costs can be spread over a broad population.

The theory predicts that democracies will tend to spiral towards ever-higher levels of interest-group dealing, centralization, sclerosis, and civic alienation. More government programs mean more complexity; more rational ignorance; and hence an even smoother

path for the next interest group. A call for more citizenship and “democracy” only accelerates the spiral. Opening the system to participation does not cure the inescapable information asymmetries. It simply means more openness for more interests, less transparency, and higher levels of ignorance.

These democratic tendencies breed centralization: only the central government can spread the costs of interest-group redistribution over a sufficiently large number of losers and, at the same time, keep the losers from voting with their feet. At the same time, democratic tendencies breed dependency on the central government, and civic dissatisfaction with it. Satisfying the escalating demands of an ever-growing number of claimants requires an ever-growing portion of the economy. Government does many more things, but none of them well. Eventually, government—at least, energetic government—suffocates under the load. Citizens complain about “special interests” and government failure; what they get in return is another, yet more ambitious program.

Tocqueville diagnosed (or rather predicted) these symptoms—centralization, government’s “enervation,” rising levels of civic discontent—as the natural results of democracy’s inherent tendencies.<sup>6</sup> The citizens of democratic nations, he feared, would eventually turn into “sheep”—ornery and whining sheep, but sheep nonetheless. The sheep, in their own way, turn out to be right: their voices don’t matter. And the more voices are heard, and the more loudly they are heard, the less they matter, because so much gets lost in the translation.

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This is where government competition enters in. The threat of exit can discipline government, and restore control over government, in a way in which citizens' voices and votes no longer can.

### **Citizen Exit**

Competition among governments has many economic advantages for citizens as consumers. But it also has important advantages for citizens, as citizens of a democratic republic. First, competition among governments reveals something more closely resembling the actual price of government policies. Second, the exit option poses none of the collective action problems that impede effective participation in the political process.

***Real Prices.*** Every political regime begets the lie appropriate to it. Stalinism begot the Big Lie—the world turned upside-down. Democracies beget an endless stream of fiscal illusions—the deliberate, persistent propagation of the myth that politics offers a free lunch. The logic of concentrated costs and dispersed benefits guarantees that political actors have an acute interest in propagating that notion; rational ignorance ensures that they will get away with it.

The American Enterprise Institute employs leading experts on environment regulation, health care, insurance policy, taxation, and many other issues. My colleagues work hard to strip away layers of deception and illusion, in an effort to discern something like the real price of government policies. I talk to my colleagues, and I am interested in their work. But I do not claim to comprehend what they are doing. If I tried, I would never get around to doing my own work, and the same is true of all my colleagues. In



other words, reasonably bright people who spend 100 percent of their working hours on policy matters can no longer understand what government is actually doing outside their areas of expertise. The notion that ordinary citizens, in ordinary professions, can penetrate the maze is simply absurd.

Competition among governments, in contrast, sends a price signal and, in doing so, dispels fiscal illusions. The departure of citizens, jobs, or capital to more hospitable jurisdictions is a rough and imperfect signal about public policy; but it is a better signal, and a much more likely cause of a tolerably informed public policy debate, than the most sophisticated econometric study. Governments will always hype the benefits of their programs; competition brings the costs into view. Government programs never reflect opportunity costs—that is, the benefits that could be had by doing things differently. A successful, competitive experiment elsewhere broadens horizons and informs democratic debates.

*The Margin and the Collective.* Democracy requires collective action. Collective action is expensive, and the costs of organizing it will be paid only by interests that can secure special, concentrated benefits for their members. The broad mass of taxpayers who pay for each program cannot be organized, since the cost of doing so would exceed the small price each of them pays for the program. Interest groups can easily obtain benefits in excess of their investments, a process that economists call “rent-seeking.”

Even very large majorities may be unable to defeat small but well-organized interests. For example, since it is very difficult to organize public opposition to expensive regulatory programs, business interests have to serve as a proxy for consumer interests. If

“big business” were unanimously opposed to intervention, it might well be able to defeat a proposed program. But the government will be very adept at promising some firms a favorable deal, and once the first firm defects, so will the second and the third.

Regulation is a foregone conclusion.

Exit, in contrast, requires no coordination. It can be exercised by a single citizen, a single firm, a single consumer, a single bond trader. The individual decisions of these marginal actors amount to an often effective articulation of a preference for less government, or less exploitative and more disciplined government. The democratic process, *sans* exit, tends to overwhelm and suppress those preferences. Competition compels government to respect them—both because exit is often cheaper for individuals and because it confronts governments, rather than citizens, with a collective action problem: short of perfect collusion, governments cannot arrest the competitive dynamics. A single “tax haven,” such as Ireland, puts pressure on all the rest.

Competition among governments, the economists say, dissipates rents. But rent-seeking is not only an economic pathology; it is also a political pathology. It produces institutional ossification, infantilizes political debate, and disempowers and alienates citizens. Competition is a corrective.

I do not mean to oversell the democratic virtues of government competition. Exit is not the citizenship of the patriot or the participant in a public debate. The student or entrepreneur who packs his bags and moves abroad is an ex-pat, not a citizen. One should be equally careful, however, not to exaggerate the anti-democratic nature of such individual choices. For one thing, a wave of ex-pats may spark a democratic debate and

decision making process that would not otherwise take place. Like Adam Smith's invisible hand, the émigré's visible feet may produce salutary results; Ireland's experience over the past two decades provides a striking example. In an important sense, moreover, exit is an important incident of democratic citizenship. A citizen who does not possess it is not a citizen; he is a subject or captive. The threat to walk out on the bums is no less fundamental to liberal democracy than the threat to vote them out of office.

It bears emphasis, moreover, that few individual choices of a better government "product" involve physical segregation or civic disengagement. The purchase of cheap T-shirts imported under a free trade agreement is an exercise of "exit." In the United States, trade unions have sponsored "Buy American" campaigns, but those campaigns have an absurd and, to my mind, mildly offensive flavor. The purchase of cheap foreign imports is neither unpatriotic nor undemocratic, and it has no effect at all on the buyer's democratic participation. It is the aggregate effect of such purchases that may send an important economic and political message.

I do not mean to oversell the actual *effects* of government competition, either. Governments may fail to respond to competition. They may respond in counterproductive ways, including ways that further obscure the true cost of government. (Selective tax abatements for companies that threaten to depart are an example.) Such failures often reflect institutional rigidities and an inability to learn and adjust. But a country may also deliberately choose to sustain an existing mix of politics, despite its costs. Competition does not obviate that choice; it simply makes the costs more visible. And because that is so, most democracies learn, much of the time, from competition. Competition among governments does what competition does in markets: it establishes equilibrium prices

and reveals information that would not otherwise come to light. At the same time, competition forces governments to respect individual preferences that would otherwise be ignored and suppressed. Certainly, that cannot be *bad* for democracy.

### **Deliberative Democracy?**

Or can it? Suppose that politics were a deliberative, authentic expression of public debate and opinion: on that theory, competition can only distort the results of the deliberative democratic process. Juergen Habermas actually defends something like this view. He contrasts markets as a sphere of pervasive exploitation with an idealized vision of politics, where free and equal citizens communicate and “discourse” in a “common public sphere.” Since the common market has already triumphed in Europe, its deleterious effects can no longer be countered at the national level. Hence, Habermas calls for the creation of a European public, a European citizenship, a European federalism, a European Constitution.

Habermas knows, of course, that the actually existing democratic “discourse” is not all it could be. Still, he marches his normative ideal into battle against neoliberalism and, from his make-believe baseline, denounces markets and competition as distortions and impositions. That strategy strikes me as unpersuasive. One ought to compare and contrast actual institutions and politics with actual markets, instead of comparing an ideal with a absurd caricature of markets. One should also be open to the possibility that politics itself distorts the democratic discourse.

Such realism would be particularly appropriate with respect to the European Union. What I have in mind in uttering this note of caution is not so much the existing

panoply of European institutions, whose lack of a democratic pedigree and accountability is too obvious to escape anyone's notice. I have in mind, rather, the project of curing the Union's "democratic deficit" by constructing a pan-European public and political discourse.

Two years ago in this forum, my teacher Jeremy Rabkin questioned the viability and wisdom of that ambitious undertaking.<sup>7</sup> America, he observed, has managed to forge a common public sphere, a common democratic culture and civic identity. But Europe cannot take comfort from the American experience, which has benefited from factors that Europe lacks—wars that created a common heritage and tradition; enormous mobility; a robust tradition of civic activism. To these considerations, one could add a spirit of pragmatism: in politics as in markets, Americans tend to go with what works. They learn by trying different things—and by letting many of them fail. Federalism is an institutionalized commitment to this experimental politics, and it has helped to sustain our democratic discourse: it is much easier to conduct a public conversation over actual experience than over ideological abstractions.

As Rabkin rightly observed, the project for a common European public sphere and democratic culture cannot avail itself of those benefits. In fact, the constitutional proposals that have surfaced since indicate that the proponents of the European project intend to *suppress* mobility, civic activism, and political experimentation (and I assume that they do not intend to wage wars for the promotion of a European identity). It is not hard to see why: mobility, civic activism, and experimentation are the virtues of markets. Mobility means that productive citizens may escape the overregulation and the burdens of

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<sup>7</sup> Jeremy Rabkin, *Making Citizens: Why American Experience Offers No Encouragement for the European Union* (The Institute of United States Studies, University of London, 2000).

the welfare state. Civic activism is often an exit from politics and a challenge and reproach to it, as when private schools and private charities work better than their government counterparts. Experimentation means government competition, including the real possibility of failure and inequality.

In the place of the competitive mechanisms that have helped to forge American democracy and citizenship, Habermas offers, as the basis for a common European public sphere, a commitment to expansive human rights and an equally expansive welfare state. From that vantage, the ideal European citizen is one who insists on “free” dental care as an acknowledgment of his “autonomy” and, taxpayer-funded dentures in place, opens his mouth to denounce America’s treatment of al Qaeda prisoners.<sup>8</sup>

I do not profess to know whether those commitments are enough to construct a European identity. What I do think I know is that they are detrimental rather than conducive to an open, deliberative democratic process. Welfare rights and guarantees reduce mobility, limit choice, and choke off debate; that is their point. (Rights put entitlements entirely beyond democratic disposition; expansive transfer programs ensure that citizens can no longer afford to vote against such programs, thus putting “neoliberal” options and parties out of competition.) What the project for a European politics actually offers is security, or at least the promise of security, against the vicissitudes of markets. Politics, in other words, holds out a promise that markets cannot deliver, and will not promise—the socialization of the inevitable losses. That is quite probably the preference

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<sup>8</sup> I grant that this formulation is aggressively polemical. But it is not unfair, and it captures the close connection between the Europeanists’ commitments to human rights and the welfare state. Prime Minister Jospin, for instance, has advocated a European Constitution as a defense of the “European way of life” against the purveyors of capitalism and globalization. While he did not specifically name those purveyors, it is clear that he did not mean Senegal. Likewise, it is fair to assume that Professor Habermas, in defining European (or, as he is careful to say, Continental) traditions in opposition to neoliberalism and the death penalty, had a particular country in mind.

of large majorities of voters on the Continent. I even concede, and in fact I fear, that the European voters' discontent may reflect a sense that their governments are not providing enough comfort and shelter. But the desire for security is a commitment to a policy outcome, not to democratic choice and deliberation. It must be defended on substantive grounds.

The commitments on which European democracy is supposed to rest, moreover, do not reflect a contemplation of new possibilities. They reflect deep-seated preferences that the European policy elites already have—except that competition, inside the European Union and from outside, often prevents the elites from acting on those preferences. European federalism would, of course, be more “democratic” than the existing institutions. But that advance will be purchased at the price of less democracy in the member-states. Greece or Spain may deliberately and democratically decide on lower standards of consumer or worker protection than richer countries that can more easily afford such beneficence. A more “democratic” Europe will harmonize those democratic choices, and the reality checks they provide, out of existence.

### **Federalism's Paradox**

The argument that competition among governments has beneficial effects for democracy and democratic citizenship holds theoretical appeal—but much less appeal or force in practical politics. The benefits are dispersed and, admittedly, conjectural, since nobody knows what politics would look like in a less competitive, open environment. The costs are concentrated: what everyone sees is that labor unions no longer get what they want, or what they once got. And so the market looks, for the most part, like a

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constraint on domestic politics and democratic choices. Put differently, the political benefits of government competition are broken through the same political prism of rational ignorance and interest group dynamics that distorts all democratic choices. Countries that are more comfortable with an open, experimental, democratic politics are more open to institutionalizing that kind of politics on an international scale. But they are also least in need of it. The countries that are most in need of a competitive reality check may be most reluctant to expose themselves to it, and least likely to absorb the lessons.

One's answer to the question of whether competition remedies (in part) the defects of democratic choices or rather thwarts them depends in large measure on one's theory and assessment of democracy and democratic practices. Juergen Habermas's disingenuous maneuver of contrasting theoretical democracy with poorly understood markets yields an unambiguous result. The opposing and, to my mind, more realistic view of politics as the milieu of interest group schemes, organized expropriation, and systemic illusion produces a different, more complicated conclusion.

James Madison, the Father of the American Constitution—or, as politically correct law review jargon in the United States now compels us to say, a “leading statesperson of the founding era”—held the latter view. His experience in the Virginia legislature had filled him with disgust for factional politics and partial laws, which he viewed as inimical to republican government. By the time Madison arrived at the Constitutional Convention, he had resolved to use that vehicle not simply for the purpose of founding a more perfect Union, but also for the purpose of fixing the internal democratic process in the various states. To that end, Madison advocated extremely nationalistic measures—prominently, a national approval requirement for all state laws.



The theoretical problem Madison never managed to solve (to his own satisfaction, let alone those of his fellow-delegates) was the origin and composition of a national body that might be capable of suppressing factional tendencies at the state level—without, however, itself becoming subject to those same factional tendencies. Partly on account of that difficulty, the Convention rejected Madison’s proposal. Instead, it adopted the constitutional solution America has inherited, which Madison defended with great ingenuity, through clenched teeth, and with considerable misgivings, in the *Federalist Papers*: Specific restrictions on interest group demands at the state level, such as tariffs, that would be particularly detrimental to sister-states. At the federal level, checks and balances that hamper the operation of factions.

Arguably, America’s experience with these arrangements have confirmed Madison’s worst fears. The anti-democratic impediments to forceful national action—the separation of powers, checks and balances—prevent much harmful national action. But they also impede the energetic assertion of national authority over interest group rackets in the states; much parochialism goes unchecked. At the same time, one can argue that the impediments to national action have proven insufficient. As Robert Nagel has argued in his recent book, *The Implosion of American Federalism*, Tocqueville’s natural tendencies towards centralization may have swamped the federalist commitment to an open, competitive politics. And so America confronts both problems at the same time—excessive parochialism, and excessive centralization.

This Madisonian nightmare suggests that an open, republican, competitive politics demands a central institution that is beyond democratic control. Friedrich Hayek confronted that ultimate federalist paradox. So did James Madison—to the point of

despairing of the entire project. In that regard, though, Madison was unduly pessimistic. His country managed to escape the horns of the dilemma in the same way it escaped most everything else—a willingness to live with pragmatic compromises, and dumb luck. The piece of luck here at issue is America’s premature birth: the Founders invented federalism and its auxiliary precautions long before the appearance of organized interests and parties. The organizations of mass democracy have managed to overrun many of the constitutional safeguards. Still, the constitutional heritage continues to resonate. American federalism was founded in defense of neoliberal values, not against them. Over the past two decades, the Supreme Court has attempted to resurrect federalism, in defiance of the United States Congress. The outcome of that struggle—perhaps, the most important dividing line in American politics—is by no means a foregone conclusion. It does demonstrate, though, that it remains possible to mobilize neoliberal values against centralizing, anti-competitive forces.

European federalism, in contrast, confronts the paradox in full force. Organized factions of a sort that Madison could not imagine have long taken a hold of politics both at the national and at the European level. The project for a pan-European “democratic discourse” lags behind those factions. It could never catch up with them even if it wanted to. But it does not want to do so in any event. The explicit purpose of the European federalists is to empower factions, not to discipline them; to suppress competition, not to institutionalize it.

The European Union’s undemocratic institutions may be the most democratic politics that the Continent may get to have. Enjoy them while they last.