

**International Conference on Federalism
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**Session 7E) EFF Roundtable:
Coping with Multi-Level Government:
The View from the Private Sector**

SOME PRELIMINARY REMARKS

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"Federalism" or the idea of multilevel governance is now widely accepted as the best founding principle for polities across the world. Decentralisation promotes welfare by bringing governments closest to the people. It facilitates tailoring of the provision of public goods according to the citizens' taste and thus enhances efficiency in the allocation of resources in the economy. Federalism also fosters political participation and helps a heterogeneous population to come together under the banner of one nation and acquire the strength of unity even in diversity. But does it also help to promote business enterprises and the free play of market forces that is so crucial for growth of trade, employment and incomes? Is federalism in any form business friendly? If not, what are the prerequisites for a federal set up to be supportive of business? The questions assume urgency in an increasingly globalising world.

This is because tensions are inherent in federal systems arising from division of powers and functions among different levels of government and the potential for conflict and overlap and thereby uncertainty and instability which are inimical to business. These have come under further strain as technology demolishes frontiers and erodes the powers of nation states on the one hand and their subdivisions on the other to pursue independent policies of their own. Can federalism survive in a globalising world with its imperatives for facilitating trade and commerce among and within nations? If so, in what form? Fundamental rethinking of the roles and responsibilities of different levels of government, and how they can be best organised to the awesome realities of the coming millennium without sacrificing the essence of federalism is called for. That is why in a conference on federalism the view from the private sector needs special attention.

The background paper for this session prepared by Mr. Brown succinctly puts forward the expectations and concerns of business under a federal regime and their anxieties for the future in the complexities of a rapidly integrating world economy. Basically, the concerns boils down to the question of environment. As

he puts it, a rational, stable, secure and predictable environment in which to operate the rule of law is what business wants in order to make long term commitments that support economic growth and prosperity. Does a federal set up provide the environment that business needs to take risks, compete and grow? Or does it smother enterprise by diffusing political power among more than one level of government and subjecting them to a multiplicity of regulations and taxation that add enormously to their transaction costs? As noted by Mr. Brown, recognition of these concerns is reflected in the acceptance of a certain discipline in the matter of trade and taxation in the form of creation of international organisations like the WTO and tax treaty agreements. Are they adequate and appropriate? If not, and they are found wanting, in what directions should they be strengthened? And what will be their impact on the sovereignty of nations? What about intra-country diversities in the laws and regulations in a federal set up that impact on businesses in diverse ways? Here again the trend is towards harmonisation and putting curbs on the authority of subnational governments in matters that affect the nation or more than one jurisdiction. Are these curbs effective and adequate? Do they not affect autonomy of the lower level governments and violate the spirit of federalism? How to reconcile the tension between efficiency and autonomy of national and sub-national governments in a manner that meet the challenges of globalisation? These are the questions that, to my mind, need to be addressed in this session.

It may be relevant to note in this context the new strands of thought emerging from the second generation theory of federalism propounded by scholars like Barry Wiengast (1995). The question that this second generation theory of federalism addresses is not whether or not federalism fosters markets but what are the conditions required for a market-preserving federalism to flourish.

According to the proponents of the new theory, for a federal country to perform well in terms of growth and raising the living standards of its people it is not enough to have a hierarchy of governments with a delineation of the powers and functions of different levels, that is merely bearing the formal marks of federalism. Several other conditions also need to be met. Such as:

- the sub-national governments should have primary authority over the economy within their jurisdictions;
- the national government must have authority to police the common market;
- there should be a hard budget constraint for all governments; and
- the allocation of authority and responsibility among governments must be institutionally durable.

[Parikh & Wiengast, 1997]

The main contributions that governments can make to promote business activity and economic prosperity, noted by Mr. Brown as most valuable are:

- providing a rational, secure and predictable environment in which to operate, and
- providing rational and stable monetary and fiscal policies for the economy.

These obviously are the objectives underlying the axioms of market--preserving federalism too. The crucial question is how to ensure that a federal polity makes a credible commitment to provide these?

The answer probably lies in creating "institutions of accountability". For, as Anwar Shah puts it, in the last analysis it is these institutions that hold the key to the success of decentralised decision making. The question that arises next is, what are the appropriate institutions to enforce accountability of governments?

Another set of questions relates to the appropriate assignment of powers and functions among different levels of government. There is a rich literature on the subject and the issues involved will no doubt be deliberated upon in other round tables. A nagging question from the viewpoint of the private sector, however, is with fast changing technologies, are the paradigms of assignment in a federal system propounded in the literature so far not getting obsolete rapidly? If, as Mr. Brown puts it, some nation states turn out to be too small for large issues and too large for small issues, what do we end up with? Supra-national authorities for large issues and national governments and their subdivisions left to attend to small ones? Can we envisage supra-national authorities that accommodate the freedom of nations without domination by the giants among them and diminution of the weaker ones? Let us hope the deliberations on federalism in this conference will provide some light. This roundtable, however, would do well to focus on appropriate institutions of accountability that alone can provide the environment for business to operate with efficiency.

Reference:

Wiengast, Barry (1995) "The economic role of Political Institutions", Journal of Law, Economics and Organisation.

Parikh, Sunita and Barry Wiengast (1997) "A comparative theory of Federalism : India", Virginia Law Review, Vol. 83, Number 7.