



# Managing International Interdependence: Polycentric, Competitive, and Hierarchical Federalism

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Notwithstanding different opinions (Spieker 2014, p. 928; Slobodian 2018, p. 102ff), we singled out and underlined major dividing lines (both normative and positive—and ultimately ontological) between Hayek's and Robbins's conceptualization of a federal supranational government (Masini 2022). While for Hayek federalism advocacy was merely instrumental to creating room for manoeuvre to the full exploitation of the virtues of catallactics, for Robbins it concerned the reconciliation between the dimension of collective market relations and collective political choices at all governmental layers, from local to global.

Going through their different ontological assumptions, a similar divide appears to have also characterized the attitudes of James Buchanan and Richard Musgrave on the role of federalism in a multi-layered context,

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Switzerland AG 2025

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B. Christensen (ed.), *Polycentric Federalism and World Orders*, Palgrave  
Studies in International Relations,  
[https://doi.org/10.1007/978-3-031-95882-3\\_12](https://doi.org/10.1007/978-3-031-95882-3_12)

as forcefully emerged from their confrontation (Buchanan and Musgrave 1999). Hence a conjecture: that a dichotomy might be identifiable between what I would label the *Cannan-Robbins-Musgrave-Olson* line of reflection on multi-layered federalism, and the *Mises-Hayek-Tiebout-Ostrom-Buchanan* one, meant to support market-preserving—and even market-enhancing—federalism.

The current paper is a first attempt to further enquire and test such conjecture against textual analysis of the main protagonists of both lines of thought. We already provided some arguments as concerns the first part of this task (Masini 2012, 2016), reconstructing the ontological divides between Robbins and Hayek, in turn deriving from their different intellectual influences from Cannan and Mises, respectively.

In these previous papers, we basically synthesized such a divide as a zero-sum (or even positive-sum, under certain assumptions) game as to the role of public authorities in the economy as concerns Cannan and Robbins; and as a negative-sum game as concerned Mises and Hayek. Summing up our argument, while for Cannan and Robbins a multi-layered structure, based upon federal constitutional principles, allows public (collective) goods to be provided more efficiently, for Mises and Hayek it is only instrumental to avoiding political interference *in* and *on* the market economy.

In this paper we shall try to address the issue of how, why and to what extent we can trace a similar dichotomy between the following protagonists of those lines of reflection on federalism, namely: Tiebout-Ostrom-Buchanan, pointing at a market-led and incentives-steered polycentric (Ostrom) and competitive (Tiebout-Buchanan) governance; and Musgrave, based on hierarchical fiscal federalism. We shall also try to underline what were the intellectual influences on them, if any, of the previous authors.

An obvious distinction describes polycentric models as dealing with horizontal interdependence, implying that the collective decision centers all enjoy the same jurisdictional status on the given territory (de facto or de jure), such as municipalities within a State, or States within a supranational framework; or at least there are “many centers of decision-making which are formally independent of each other” (Ostrom, Tiebout, and Warren 1961, 831). While hierarchical federalism is concerned with a vertical distinction based on the different extension (and dimension of the underlying constituencies) of public entities: the relationship between a municipality and its State, or a State and supranational organizations,

etc. The distinction, though, appears to be much more profound, having to do with the very idea of social order, and of the role and nature of public institutions.

There are several historiographical questions that arise from this issue. What is the role of competitive federalism in this dichotomic picture? Is it close to—or overlapping with—polycentric governance, at least from the ontology of society they both imply? Or is it one extreme, being polycentric governance indeed a “third way,” as the Ostroms (see Ostrom E. 2010) meant to achieve? In this paper we shall concentrate on whether polycentric and hierarchical trans-national governance are compatible or opposite ways to conceptualize transnational externalities and to design a multi-layered governance. Anticipating part of the results of our enquiry, we can suggest that although polycentric governance and hierarchical federalism are only two faces of the same coin, that is how to tackle trans-layer interdependence (among different public authorities), they imply radically opposite ontological assumptions and prescriptive answers.

To illustrate this, we shall recall the main elements of both systems of thought, highlighting similarities and differences. We shall first briefly recall the divides that characterized the pre-WWII European debates on multi-layered collective action and introduce the similarities (and differences) with the post-WWII USA ones (next section); we shall then enquire into polycentricity and competitive federalism (second section), before dealing with hierarchical fiscal federalism (third section).

## COLLECTIVE ACTION AND FEDERALISM ON THE TWO SIDES OF THE ATLANTIC

The conceptualization of supranational collective goods and transnational externalities is increasingly becoming a key, at the same time critical, figure in international relations, economics, and political science. Problems of collective action deriving from the need to provide increasing amounts of transnational public goods—such as contrast to climate change, poverty reduction, pandemics management, universal access to primary resources—have raised the attention of both academics (d’Arge 1975; Killinger 1996; Nordhaus 2015) and think-tanks, especially since the pioneering and controversial contribution of the Club of Rome (Meadows et al. 1972, Tinbergen 1976; Stern 2006, etc.).

In more general terms, the existence of external transnational influences was central already in Boulding (1946), to the point that he called

for post-WWII countries to insert in their constitutional chart a “declaration of interdependence,” in which they should acknowledge that their behavior depended and impacted upon the room for manoeuvre of other States, constraining their respective collective choices.

The optimal coordination among different layers of institutions for the provision of collective goods, which is one crucial *problem of collective action* (Olson 1965), was—and still is—a relevant issue in both European and US economic and political thought. It became crucial in Europe during the interwars years, when attempts were made to designing the logic, structure, and institutions of a supranational—European—economic and political system, at the same time sufficiently decentralized as to account for different national preferences and centralized to acknowledge strategic interdependence; and the need to exercise some shared sovereignty in specific fields, thus avoiding conflicts to degenerate into wars. As Musgrave (1965, 2) underlines: “Across the Atlantic [meaning: in Europe] fiscal thinking has been stimulated by the movement for European economic integration.”

This is the reason why the issue of collective action in a multi-layered context was largely analyzed, especially during the 1930s, by major European (intellectually heterogeneous) economists such as Beveridge, Einaudi, Hayek, Heilperin, Perroux, Robbins, Röpke, Wootton, just to name a few. Acknowledging the successful experience of the Philadelphia Convention of 1787, when the federal constitution of the USA was agreed upon, they became supporters—in different degrees and for very different reasons (Masini 2012, 2016, 2022)—of a federal union for Europe as a project to be implemented after WWII. Struggling for the *United States of Europe* would later become a political project, at the end of the war, thanks to intellectuals and civil servants like Monnet, Spinelli, Uri, etc.

Such intellectual effort was taking place in an era of corporatism, étatism, fascism, and Nazism, characterized by the degeneration of collective action in political abuse on both society and the economy. Hence the unavoidable overlapping of such debate with the one on the *economic calculation problem* and its related issues concerning the nature of knowledge and information, the relative role of market and politics, etc.

The degree of optimism (or pessimism) over the possibility of a benevolent collective action was a dividing line between members of the above-mentioned group, leading some of them to suggest a supranational (technocratic) federation as an instrument to reduce the (pathological)

interference of politics in the economy; and some others to designing a multi-layered system of democratically legitimated institutions, each endowed with limited but fully enforceable sovereignty on a given (varying, according to each author) set of competences. Hence the divide between what we called *instrumental* (centered around Hayek) and *constitutional* (centered around Robbins) federalism, with all the other protagonists of the debate in between these two lines of thought (some not even fully aware of such profound ontological divide).

On the other side of the Atlantic the issue concerning the optimal balance between centralization and decentralization in a multi-layered governmental framework became pressing after the skyrocketing increase in federal spending during the Roosevelt era that, later shadowed by the war effort, came to the fore of academic and public debate after the end of WWII.

The problem in the USA was different from Europe. While in the latter it was concerned with building a supranational governmental level from below (from national sovereigns), in the USA it concerned how to reduce the weight of the supranational federal government to be more efficient and allow for greater freedom of choice for national and local communities, as well as for individuals.

This distinction led to a profound reconsideration of the relationship between the individual and the many collective communities he belongs to. As J.R. Commons noted in 1950: “This is an age of collective action [...] collective action is the general and dominating fact of social life. Human beings are born into this process of collective action and become individualized by the rules of collective action. Thus, an institution is collective action in control, liberation, and expansion of individual action” (Commons 1950: 23).

“Groups” come to be considered a third subject between the market and the State, usually judged as exerting a positive influence on social welfare. The problem is no longer how to defend the public sphere from sectional interests expressed by influential groups, as it was in the Thirties, but how groups can help solve government failures. This paves the way to studying the relationship between public goods and public authority.

As concerns the theoretical apparatus conceptualizing (national) public goods and (national) public action, the Samuelson (1954)—Musgrave (1939, 1959) solution to the optimal provision of public goods, implying externalities that are assumed to concern the whole (nation)State, is the

need for a centralized (national) governmental provision, to avoid free riding problems.

As the more direct effect of different layers of government on individuals is their power to levy taxes, an increasing literature explored different models of multi-layered tax—and related governments—design. This is the reason why, in the USA, the relevant debate was in the field of public finance.

The first celebrated attacks on the (allegedly) overwhelming role and weight of the federal budget and government came from Tiebout (1956); later from Ostrom, Tiebout, and Warren (1961) and Buchanan (1962, 1965). While their research program focused on fiscal competition, polycentric governance and competitive federalism, a radically different approach was the one explored by Musgrave (and partly Olson) on fiscal federalism. We shall deal with these two different lines of reflection in the next two sections.

## THE ONTOLOGICAL FOUNDATIONS OF POLYCENTRIC GOVERNANCE

Tiebout's (1956) pioneering work *A Pure Theory of Local Expenditures*, firstly presented in a workshop organized by Musgrave, and later published in *Journal of Political Economy*, challenged the idea of a mono-dimensional nature of public goods implied in Samuelson (1954) and Musgrave himself, identifying a multi-dimensional structure related to the supply and demand for public goods. Although his work is very differently interpreted (Dowding et al. 1994; Singleton 2015), Tiebout's concern was to allow for government competition, making local governments as mere producers of goods which can be priced and chosen on the market; to designing a non-political solution to the problem of free riding.

It is a very special market, requiring consumers, who "vote with their feet," to make a choice in terms of mobility. If the individual does not agree with the collective choices of the community he belongs to, he can exit in search of a different group where his preferences are better matched.

It might be interesting to have a look at his very stringent assumptions. First, the collective good the individual is seeking to consume must generate externalities that need to coincide exactly with local constituencies (Tiebout 1956: 419), which is very unlikely. The second assumption is that an alternative provider of local public goods may always exist (at

small transaction costs), to provide an alternative to individuals. This is not always the case: I may be attracted by a lower income tax jurisdiction, where nevertheless some collective goods previously provided by the outgoing jurisdiction are not provided at all by the new one. The third assumption is that any individual can always change his local constituency, but he is not allowed to form a trans-jurisdictional group: no civil society organization is envisaged as a possible provider of collective goods. Only administrative jurisdictions, competing with one another, are allowed to provide collective goods.

Given this framework, competitiveness is the only mechanism required to provide incentives for public policies. Local jurisdictions will compete to match best the preferences of the individuals they want to attract. No coercion is necessary as everyone is always free to choose the preferred jurisdiction. Nevertheless, as Laurie Reynolds underlines, the “highly fragmented local government world envisioned by Tiebout inevitably results in a self-destructive competitive ‘race to the bottom,’ as municipalities try to out-bid each other in the incentives they are willing to offer to entice business and the property wealth it brings into their jurisdictions” (Reynolds 2003, 105). And she argues: “the theory improperly emphasizes the consumer-voter’s likely exercise of choice in the selection of local government. Instead of focusing exclusively on the threat of ‘exit,’ they argue, the theory should recognize the importance of citizen ‘voice’ in motivating local government officials” (*ibidem*).

It may be true that, as argued by Singleton (2015): “the article failed to influence the stabilization of postwar public good theory despite Tiebout’s engagement with key figures in its construction. Moreover, his death preceded the application of its central mechanism to public, urban, and environmental topics via hedonic, sorting, and computational general equilibrium models. Viewed in this way, the history of Tiebout’s article, and thereby the history of public economics, has remarkably little to do with Tiebout himself.” At the same time, Tiebout’s influence on the subsequent literature on competitive federalism and polycentric governance cannot be neglected. And Fishel (2000: 8) argues that the problem raised by Tiebout, later developed in an article titled *An Economic Theory of Fiscal Decentralization* (Tiebout 1961), influenced the *Economic Theory of Clubs* by Buchanan (1965), since the model of local government suggested by Tiebout seems to be similar to the cases made by Buchanan (there is no mention of Tiebout’s article, though, in Buchanan’s work).

In 1958 Tiebout moved from Northwestern University, where he was Assistant Professor, to UCLA (University of California at Los Angeles), where he would soon become Associate Professor. At UCLA, Vincent Ostrom had been awarded a PhD in *Political Science* in 1950 and Tiebout's approach to competitive local administrations perfectly matched Ostrom's attempt to provide a new, innovative view on governing the commons. An approach that, as McGinnis (2010, iii) recognized in his introductory statements to an issue of the journal *Transnational Corporations Review*, "challenged my very use of the term 'state,' a concept that had been foundational to my graduate training in the political science of international conflict."

The State for both Vincent and Elinor Ostrom is nothing but a competitor in the provision of welfare to individuals. And it usually bears costs higher than benefits when it comes to regulating local commons. The subsequent *Bloomington School of Political Economy* (Cole and McGinnis 2015), founded at the University of Indiana by the Ostroms is a testimony of the research effort to demonstrate this with empirical analyses. It should be noted that the Bloomington School was one of the three leading centers of the *Public Choice Theory*, together with Buchanan's and Tullock's *Virginia School of Political Economy* and Riker's *Rochester University* (Boettke and Coyne 2005:147). Elinor Ostrom (2011) also acknowledged the extraordinary intellectual influence that Buchanan exerted on her husband and herself.

The third academician that Tiebout and Ostrom came in touch with was Robert Warren, who was Assistant Professor of *Political Science* at the University of Washington. From Wagner (2005, 179) we learn that a source of inspiration for all of them was De Viti de Marco's (1936) *First Principles of Public Finance*, whose concept of the State very much resembled (according to Warren) that of polycentric governance, as polycentric processes of human interaction are the basis to design an optimal government. We should not forget that the *Italian School of Public Finance* (of which De Viti De Marco was among the most authoritative members) was also one major, explicit, inspiration for Buchanan and the *Public Choice School* (Boettke and Coyne 2005:153).

This ontological empathy on the relative role of public authorities and individual freedom gave rise to their pioneering contribution of 1961: *The Organization of Government in Metropolitan Areas: A Theoretical Inquiry*. In their contribution to its definition Vincent Ostrom, Tiebout, and Warren (1961) examined "polycentric political systems" as systems



where many—independent from each other—decision-making centers in a competitive relationship acknowledge the existence of other similar centers, determining a(n apparent) system of interdependent choices that leads to consistent and predictable behaviors.

The term was not brand new, as the word “polycentricity” had been used with a slightly different meaning by Michael Polanyi (1951) in his *The Logic of Liberty*—and would be resumed by Hayek’s (1960, 160) in *The Constitution of Liberty*, where Polanyi is explicitly cited. Although the concept—from Polanyi to Ostrom, Tiebout, and Warren—evolved (according to Cole and McGinnis 2015, xxi it “dramatically changed”), for all of them it refers to a system made up of components that must necessarily acknowledge the interdependent behavior of others. For Polanyi and for Ostrom, Tiebout, and Warren the system can be conceptualized as made up of parts where each cannot behave as if the others do not exist but needs to take into account others’ behaviors.

While for Polanyi such interdependence is mechanical, therefore deterministically inferred upon despite the complexity of the model, which is the only limit to the prediction of its evolution, in Ostrom, Tiebout, and Warren, being dependent upon formal and informal power relationships, no deterministic outcome is predictable.

The ontological assumption behind Ostrom, Tiebout, and Warren (1961) is made manifest in the introductory remarks, when they argue: “this view assumes that the multiplicity of political units in a metropolitan area is essentially a pathological phenomenon” (Ostrom, Tiebout, and Warren 1961, 831). This is not an issue to be tested against factual/textual analyses, but it represents their *Weltanschauung*; that they mean to support.

The key point they address is how to transform such pathology into an asset for collective decision-making. Here is where a competitive framework comes in. To better design the appropriate boundaries of government in dealing with the problem of scale connected to the provision of public goods, the authors draw political frames as structures to deal with the problem, and define criteria of control, efficiency, political representation, and local self-determination assuming that public goods can be internalized. Their first suggestion is to build a *polycentric political system* within the public dimension, through a model of multiple jurisdictions reflecting a multiplicity of interests in various public goods demanded by the inhabitants of a metropolitan region.

Secondly, the polycentric system is based on the satisfaction of the needs of a broader community—beyond the geographical or functional limits of each of the formal entities within the metropolitan region. Therefore, the authors argue that polycentric governance is also supposed to provide a variety of public goods with many scales of organization and in supplying optimal arrangements for the production and consumption of public goods: “With the development of quasi-market conditions in production, much of the flexibility and responsiveness of market organization can be realized in the public service economy” (Ostrom, Tiebout, Warren 1961: 839).

At the same time, they are aware that cases must be allowed for where central decision is key for the effectiveness of the system. When they suggest a parallel between firms in an industry (given their twofold pushes towards competition and collaboration, as is manifest in the Marshallian industrial district) and governmental units ruling upon a jurisdiction, they argue: “collaboration and competition among governmental units may also, of course, have detrimental effects, and require some form of central decision-making to consider the interest of the area as a whole” (*ibid.*, 832).

This is, for example, the case with negative externalities, “the management of a refinery which bleaches out smoke has little incentive to eliminate the smoke. Control of internalization usually falls upon public agencies. A function of government, then, is to internalize the externalities—positive and negative—for those goods which the producers and consumers are unable or unwilling to internalize for themselves, and this process of internalization is identified with the *public goods*” (*ibid.*, 832–3): the standard Pigouvian solution.

Such externalities may nevertheless be internal to a group but external to another, once the environmental conditions change. They make the example of a household heating system. If the family increases there will be no change in the cost of maintaining the heating system, hence we have a positive externality on the increased family. Such externality, though, will not affect the community as a whole.

Their conclusion is that “where a public good is adequately packaged within appropriate boundaries, it has been successfully internalized. Where externalities spill over upon neighbouring communities, the public good has been fully internalized” (835). The problem with this is that efficiency would require “the modification of boundary conditions as

to assure a producer of public goods and services the most favorable economy of scale, as well as effective control” (836).

This is a critical issue when trying to widen the validity of polycentric governance to the issue of transnational interdependence. Tiebout, Ostrom, and Warren underlined in the first footnote that the validity of their model was meant to be much broader than metropolitan areas: “polycentric political systems are not limited to the field of metropolitan government. The concept is equally applicable to regional administration of water resources, regional administration of international affairs, and to a variety of other situations” (831). The problem is that transnational boundaries cannot be changed to match the needs of economic efficiency.

The only pragmatic mechanism to ensure a realistic, viable, and operational architecture would be to design a competitive environment, unless we are ready to accept the increased transaction costs implied in the *Functional, Overlapping, Competing Jurisdictions* model of Frey and Eichenberger (1999) and Frey (2005): a theoretically efficient system, which is nevertheless impossible or too costly to implement.

During the sixties, Vincent Ostrom developed several works on public policy and decision-making mechanisms, mostly related to the problem of water resource management (1963a, b, 1964, 1967). In 1973 at UCLA, the Ostroms founded the *Workshop in Political Theory and Policy Analysis* aiming to create an intellectual effort dealing with the interconnections between theoretical and practical problems in public policy (Boettke and Coyne 2005:147). The workshop had an interdisciplinary approach with a major focus on the “development of political theory as an analytical tool to be used in the design and conduct of empirical research and in the study of public policy problems” (Jagger 2009, 2). Their aversion to model-thinking, as well as the fact that “the research agenda of the Ostroms draws significantly from the ideas developed in the first half of the twentieth century by Knight, Mises, and Hayek” (Boettke and Coyne 2005, 157) are interesting features. Indeed, in his work *Polycentricity* for the 1972 Annual Meeting of the *American Political Science Association*, presented by Vincent Ostrom as the development of his work of 1961, the author writes: “Polycentricity is not confined to market structures but can apply to the organization of diverse political processes and by implication can apply to the political process as a whole. A polycentric political system will be one where each actor participates in a series of simultaneous games and where each act has the potential for being a move in simultaneous games” (Ostrom 1972: 8).

From this perspective, the work by Ostrom, Tiebout, and Warren could be seen as an affirmation of the primacy of individuals and small communities over the government (State) through the lever of competition and the idea of society as a market order: “Patterns of competition among producers of public services in a metropolitan area, just as among firms in the market, may produce substantial benefits by inducing self-regulating tendencies with pressure for the more efficient solution in the operation of the whole system”(Ostrom, Tiebout, Warren 1961: 838).

It should therefore not come as a surprise to claim that Elinor Ostrom’s contribution—which is the most celebrated follow-up of Ostrom, Tiebout, and Warren (1961) on polycentric governance—would represent an articulation of both the neoclassical and neoliberal thought. Her epistemological approach rests on the assumption of methodological individualism (Forsyth and Johnson 2014), knowledge and information dispersion and complexity. It is on these bases that Elinor Ostrom continues the work of her husband through the methodology of *field studies*, mainly based on water management (Ostrom E. 1965, 1967). Incentives, once polycentricity is acknowledged, are enough to establish and maintain a social order and a welfare-maximizing governing structure. The research project of Tiebout, Ostrom and Warren would also be continued by Demsetz (1967), although focused on communal ownership and on non-hierarchical relations that should characterize their management.

A slightly different direction in this research project on multi-layered governance was taken by Buchanan. As an intellectual influence, Buchanan often recalled the importance of Wicksell’s (1896) criticism against the idea of a benevolent despot and of the *Italian School of Public Finance*, that pushed him away from his early attitude of “committed libertarian socialist” into the awareness of the “coordinating properties of markets” (Buchanan and Musgrave 1999, 16). From this point of view, key was the assumptions that those Italian economists held about the nature of politics, in turn influenced by the ill-conceived role that politics exercised in Italy, especially since the advent of fascism and corporatism.

Buchanan, such as Mises and Hayek, was in search of supportive arguments against the constraining, abusing role of politics over the economy. In the Italian economic literature Buchanan found what he was looking for: a sceptical view of public bodies, not as ideal servants aiming at an ideal social welfare but aimed to fight for curbing social choices to his

survival and greed. Hence the criticism against any “social welfare function,” built on “a healthy dose of Italian realism about politicians, politics, and bureaucracy” (Buchanan and Musgrave 1999, 19).

The next intellectual step, that owed much to the influence of Henry Simons and Ludwig von Mises, as he recognized (*ibid.*, 20) was the writing with Gordon Tullock of *The Calculus of Consent* (Buchanan and Tullock 1962), where they laid the foundation of the radical criticism on majority voting. Unanimity voting certainly brings Pareto-efficiency, thus defending individuals from the tyranny of majority: “I have always looked at federalism as a means by which you can restrict or have some control, through built-in institutions that will control the power of the government” (Buchanan and Musgrave 1999, 177). As is the case with Tiebout and Ostrom, Tiebout, and Warren, competition proves the only framework for individuals and jurisdictions to be fully free in their choices.

It is interesting to observe that Buchanan’s critique against Musgrave idea of hierarchical fiscal federalism lies in the latter’s assumption that the political structure is a given data, while Buchanan is “not willing to presuppose a political structure.” With competitive federalism, “you are giving people, individuals, as resource owners and as residents, an exit option. If there is an exit option, if there is a chance to leave, this necessarily imposes a discipline on those who would exploit you through a political structure or a bureaucratic structure” (179).

It is not Hayek’s technocratic solution to the problem of their aggregates into fencing off policies from the economy but the ontological understanding of society they imply is very similar. And federalism is a way to fence off political abuse from individual unfettered freedom. Robbins (1939) would describe this not as liberalism but anarchism.

## INSTITUTIONS AND COLLECTIVE ACTION: HIERARCHICAL FISCAL FEDERALISM

A different approach from Tiebout, Ostrom, Warren, and Buchanan can be found in Musgrave (1957, 1959) and many of his later works. Musgrave’s most relevant intellectual influences can be traced back to authors such as Locke, Bentham, Sidgwick, Wicksell, Pigou, Wagner (Musgrave 1986, vii ff; Buchanan and Musgrave 1999). His early education was built-in Germany before he moved to the USA in 1933.

His motivations to devote himself to public finance are well expressed in *Public Finance in a Democratic Society* (Musgrave 1986), where he

argues: “intelligent and civilized conduct of government and the delineation of its responsibilities are at the heart of democracy. Indeed, the conduct of government is the testing ground of social ethics and civilized living. Intelligent conduct of government requires an understanding of the economic relations involved; and the economists, by aiding in such understanding, may hope to contribute to a better society. This is why the field of public finance has seemed of particular interest to me” (ibid, ix).

As we can read in the *Introduction* to the volume edited with Alan Peacock (Musgrave and Peacock 1958, xvii), in public economics: “the basic principle is collective needs. These needs are felt subjectively by the component public authorities, and by individuals in so far as they think as members of the community. The public economy thus rests on the sacrifice of its members. The individual feels as a member of the community; and where this is not the case, coercion forces him to act as if he felt in this fashion.” While individual wants are fine with market relations, collective needs become crucial in public finance.

As they recognize: “the difference is not one of logic, but of value judgements and social philosophy” (ibid., xviii). His perspective is from the point of view of society, not of the single individual, and this represents the major ontological divide with Tiebout, Ostrom, Warren, and Buchanan.

The basic assumption behind his theoretical construction is that “fiscal resources are needed to execute state functions” (Buchanan and Musgrave 1999, 30) and the State is in turn “a contractarian venture, based on and reflecting the shared concerns of its individual members” (Buchanan and Musgrave 1999, 31). But “the visible hand of the budgetary process [...] is no less ‘natural’ than the invisible hand of the market. A variety of needs are to be met and tasks to be undertaken, some better served by the former and others by the latter mode. Failures arise and need to be dealt with under both, with both rendering essential and complementary contributions to the social order” (Buchanan and Musgrave 1999, 31).

This argument already sets a dividing line between the ontological understanding of social order by the previously enquired authors, Buchanan above all, and Musgrave, very much in line with Robbins’s (1937) argument (that Robbins extended to each—concentric—layer of government): a social order cannot rely only on Pareto optimality without prejudice to the sustainability of that order itself (Buchanan and Musgrave

1999, 31–32). A social order is not a mere aggregate of individual preferences. And although the power of government needs sometimes to be restrained, also individuals' freedom needs sometimes to be restrained if they must coexist and form some kind of society: "to impose such restraints, collective action by the democratic state is needed" (*ibid.*, 129).

In Musgrave, fiscal federalism fully recognizes that the provision of public goods is dependent upon different constituencies, as in Tiebout. But contrary to Tiebout's model, Musgrave designs fiscal federalism to solve problems of incoherence between the extent of externalities and the extent of the governing body legitimated to choose on them. As was the case for Robbins,<sup>1</sup> Musgrave's fiscal federalism assumes that every collective good can be provided by a specific level of government: neither overlapping nor competing situations can exist because when externalities arise from the consumption or production of a particular good, the provision of that very good is assigned to a greater constituency. Public authorities, through their concentric and articulated structure, match all the requirements of the society.

Fragmentation and competition are not the best solution to avoid abuse; as Desmarais-Tremblais (2014, 31) argues: "contrary to Buchanan, Musgrave did not favour forging small number interaction situations, partly because it creates a new set of imperfections due to strategic behaviour." As Musgrave writes, Buchanan relies on "fiscal competition as against coordination as an ordering device" (Buchanan and Musgrave 1999, 155).

Hence the need to rely on a hierarchical structure of federal powers, guided by a sort of subsidiarity principle depending on economic efficiency, in turn depending on the ability to internalize externalities. As he puts it: "to secure an efficient outcome, the provision of public services should be determined and paid for by those who benefit. Public goods and services should be provided and paid centrally, while those with local benefit reach should be provided for locally" (*ibid.*, 156).

In a way, it is a direct attack against De Viti De Marco's (and his followers) "voluntary exchange theory of public policy" (Musgrave [1939]1986, 3), as he admits: "the construction of a theoretical model

<sup>1</sup> Although they shared some of their intellectual influences (such as Locke and Sidgwick), I am not aware of any reference to Robbins in Musgrave's works, nor to Musgrave in Robbins' works. This reinforces the idea that, though ontologically close to one another, their works stemmed from different questions and urges.

of public economy in terms of voluntary exchange is defective, if it constitutes a derivation from justice norms rather than a realistic interpretation of the actual revenue expenditure process" (*ibidem*). Even before the contributions of Tiebout, Musgrave made it clear that "the contention that fiscal policy in the modern community—democratic or authoritarian—is determined as a direct resultant of the mutual agreement of a multitude of contributors, acceptable to each and all of them, at best constitutes an unacceptable simplification of the highly intricate political process through which collective decisions are arrived at" (*ibid.*, 7).

To summarize, Musgrave argues that "the market, efficient and helpful as it is, does not by itself constitute a moral order. The vision of a more order, based on self-interest only, is incongruous. The very concept of a moral and good society involves individuals in their relation to others" (Buchanan and Musgrave 1999, 232–3). And "relating to the wellbeing of others only in the context of mutually profitable exchange seems to me amoral at best" (Buchanan and Musgrave 1999, 226).

And concludes: "my choice, and I will refer to it here as the 'good society,' is one that combines the self-interested-based principle of the market as an efficient institution with justice at communal concern for others as its moral input. This recognizes that the market resolves one major aspect of social relations but by no means all of them" (Buchanan and Musgrave 1999, 226). Hence the need for a different structure than pure competitive relationships among jurisdictions.

Let us just briefly recall that an even more radical approach than the one supported by Musgrave is illustrated by Olson (1965: 2), who underlines that: "unless there is coercion or some other special device to make individuals act in their common interest, rational, self-interested individuals will not act to achieve their common or group interest."

Incentives can play a role, but the problem with them is that it is difficult to find a mechanism that provides incentives *to all* the members of the community, therefore needing either an individually based weight system or a Pareto sub-optimal solution. This is not necessarily a problem, but it is not clear why the market should be more legitimated than a democratic council to decide who should bear the onus of financing the collective good.

Olson's (1965) idea is that when the decision-making mechanism is not framed within a juridical context where democratic legitimacy (and certainty of a final decision) is constitutionally enforceable, the most plausible result of collective choice is the status quo, where no choice at all is



taken. If this can be socially optimal from a Pareto point of view, it usually implies the under-provision of essential collective goods whose lack may undermine the very existence of the group (Olson 1969). A solution may be to build a constitutional rule obliging stakeholders to take a decision; and to make this decision work without any veto rule (Sen 1970). This means having a governmental body to which the competence over the production of that good is assigned, as was the case for Robbins and Musgrave.

## CONCLUDING REMARKS

We followed the evolving thought of different intellectuals and highlighted how the ontological and intellectual divides that characterized the reflections on the virtues of (different ideas of) federalism in Europe in the Thirties was exacerbated in the USA after WWII. While in Europe, between the two world wars, federalism was an exercise in institutional design, to be tested against a future regional integration process, the USA were already an established federation, that needed to be managed in the most effective way, compromising between the ever-increasing demand from individuals and sub-federal jurisdictions for greater autonomy, and the need for strategic unity and socio-economic justice.

The two main lines of reflection that emerged since the late 1950s in the USA were: polycentric governance, steered by spontaneously emerging incentives (Ostrom, etc.) and governmental competition, to be constitutionally guaranteed (Tiebout, Buchanan); and a more efficient structure of fiscal federalism, based on a multi-layered allocation of competences and strict enforcement rules (Musgrave, Olson).

The first point to be underlined is that, despite such profound divides, both lines of reflection—that we attributed to Ostrom, Tiebout, Warren and Buchanan on the one side and to Musgrave and Olson on the other—were pushed towards theorizing on the constitutional nature of multi-layered governance by the same problem: how to manage best and more effectively the potentially negative effects of interdependence.

From this point of view, *polycentric governance* and *competitive federalism* lie in the same ontological field, as they both assume that governmental action is always detrimental to the full freedom of choices of individuals and ontologically incapable to struggle for the general welfare. Hence the need to fence off collective action from individual action, thus allegedly reducing the impact of negative externalities on (individual)

choices, once a constitutional order is established that sets the rules for competition.

*Hierarchical federalism*, which assumes that only through enforcement and coercion individual freedom can be safeguarded by abuses of both asymmetric individual and collective power and abuse. This dichotomy bears some important consequences as regards trans-national externalities because the former view suggests a loose cooperative structure of international organizations is best suited to safeguard individual (actually State) freedom, while a federal supranational order would imply giving up some prerogatives of individual (State) freedom for the sake of the collective good.

As we already underlined in the introduction, both strains of thought should be contextualized to the intellectual debates and historical contexts whence they emerged. At the same time, public debates are easily forgetting (or ignoring) such contexts and tend to assume the conclusions of each model may be universal. But the key issue here is that the distinction between the two is similar to the dividing line that we already observed for the previous authors (Mises and Hayek on the one side; Cannan and Robbins on the other): on the side of polycentric governance and competitive federalism individuals try to escape from public (collective) authorities, even as concerns the provision/consumption of public goods; with hierarchical federalism each layer is constrained under the (enforced) legislation and authority of some public body, their distinction relying only on territorially concentric extension.

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