Journal of Economic Perspectives, Volume 11, Number 4, pp.83-92, Fall 1997

Federalism as a Commitment to Preserving Market Incentives

Yingyi Qian and Barry R. Weingast

Abstract

We advance a new perspective in the study of federalism. Our approach views federalism as a governance solution of the state to credibly preserving market incentives. Market incentives are preserved if the state is credibly prevented from compromising on future economic success and from bailing out future failures. The salient features of federalism — decentralization of information and authority and inter-jurisdiction competition — help provide credible commitment for these purposes. In addition, we discuss factors relevant for sustaining federalism.

■ Yingyi Qian is Assistant Professor of Economics, and Barry R. Weingast is Senior Fellow, Hoover Institution, and Ward C. Krebs Family Professor of Political Science, all at Stanford University, Stanford, California.

Federalism as a Commitment to Preserving Market Incentives

Traditional economic theories of federalism emphasize two well-known sources of benefits from decentralization. First, Hayek (1945) suggested that, because local governments and consumers have better information than the national government about local conditions and preferences, they will make better decisions. Second, Tiebout (1956) argued that competition among jurisdictions allows citizens to sort themselves and match their preferences with a particular menu of local public goods. In this spirit, Musgrave (1959; see also Oates 1972) showed how the appropriate assignment of jurisdictions over public goods and taxes can increase welfare.

Although these theories study central features of federalism, they do not completely characterize the function and benefits of federalism. First generation economic theories ignore the problem of why government officials have an incentive to behave in the manner prescribed by the theory. They take for granted that political officials provide public goods and preserve markets.

Notice the parallels between the first generation approach to federalism and the neoclassical theory of the firm. Both treat the organizations they study — firms and governments — as black boxes run by people who act benevolently — for shareholders or citizens. Both theories provide only a modest explanation for why managers or government officials would behave in the prescribed manner.

The question we address is, how do governments commit to providing efficient public goods and preserving market incentives? The answer lies in the governance structure of the state (Williamson 1997). Preserving markets requires that the state be effective yet limited. Several mechanisms are known to further this objective, such as the rule of law, horizontal separation of powers (e.g., into the executive, judiciary and legislative branches), and democracy, but all are imperfect. In this paper, we suggest that federalism — the appropriate decentralization from the central to local governments — provides another solution.

Influenced by advances in the new theory of the firm,[1] we offer a new, second generation economic theory of federalism. The theory of the firm studies a wide range of incentive problems that plague firms, assuming that no natural reason compels managers to favor shareholders. The theory shows how firm institutions and governance structures can be structured so that, interacting with the market, they align incentives of managers with the interests of shareholders. As with the theory of the firm, we assume there is no natural reason for political officials to further the interests of citizens. Like firm managers, if given the opportunity, political officials will appropriate the lion's share of the rents from political decisionmaking. Again in parallel with the theory of the firm, we argue that the appropriate political institutions align incentives of political officials and citizen welfare.

In what follows, we study the problem of how governments preserve markets. Efficient markets require two related aspects of credible commitment by the state. The state must maintain "positive" market incentives that reward economic success. When the government is tempted to take away too much income and wealth generated by future success, individuals have no incentives to take risks and make effort today. In the terms of North (1990), this is

1 See, e.g., Coase (1937), Grossman and Hart (1986), Holmstrom and Tirole (1989), Milgrom and Roberts (1992), and Williamson (1985).

the "state predation" problem. The state must also commit to "negative" market incentives that punish economic failure; if the government is tempted to bail out failed projects or continue costly, inefficient public programs, individuals have no incentives to avoid mistakes and waste. In the terms of Kornai (1986), this is the "soft budget constraint" problem.

Thriving markets thus require that governments solve this problem through credible commitment (North, 1990; Weingast, 1995). Historically, as North (1981, 1990) suggests, most states have failed to achieve sufficient credible commitment to markets. This does not mean that political officials are malevolent, however. In the developed world, problems typically arise for a different reason. Political officials may be sufficiently honest and possess good intentions. Nonetheless, in the name of good intentions, they often produce bad economic policies. Political officials face pressure to provide benefits to a range of groups and constituencies; they may levy too high tax on economic success in the name of poor people; they may mandate the provision of private benefits through regulation; and they may be tempted to borrow too much from future generations. Political officials also face pressure to intervene to save jobs by rescuing ailing firms and bailing out bad projects. In combination, these activities compromise the positive and negative incentives necessary for markets.[2]

We approach this question using the insights and analytical tools from the new theory of the firm. Two lines of ideas are relevant for studying federalism. First, the allocation of information and authority directly affects the degree of commitment. In particular, efficiency can arise in a dynamic setting if the principal gives up some information and authority.

2 These problems are exacerbated in the developing world, where government officials often face few incentives against syphoning off resources for personal gain.

Second, competition can be used as a disciplinary device in the presence of managerial incentive problems, forcing managers to reflect the interests of shareholders.

We have only tentative beginnings on these problems.[3] Paralleling arguments in the theory of the firm, we suggest how the features of federalism — decentralization of information and authority and inter-jurisdiction competition — can provide credible commitment to secure economic rights and preserve markets. Specifically, providing the central government less information and power in particular areas increases the credibility of commitment. This combines with the induced competition among local jurisdictions to provide local political officials with the incentives to pursue citizen interests. In addition, we also identify some factors relevant for sustaining federalism. This approach goes well beyond the traditional studies of federalism and decentralization in the spirit of Hayek and Tiebout.

Our approach rests on the important work of several economists. Buchanan has long drawn attention to problems with the assumption of benevolent government (Buchanan and Tullock 1962, Buchanan and Brennan 1980), though we disagree with his modeling strategy of assuming a malevolent government. A range of models (e.g., Epple and Zelenitz 1981; Courant and Rubinfeld 1981; Inman and Rubinfeld 1979) show how inter-jurisdiction competition limits but may not eliminate inefficiency, given particular features of local public goods provision, such as immobile land. More recent Inman and Rubinfeld (1997a, 1997b) have articulated a complex positive theory about how the politics of public expenditure programs and budgeting introduces a range of inefficiencies.

---

3 Our work draws on the following: Frye and Shleifer (1997), North and Weingast (1989), McKinnon (1995, 1997), Montinola, Qian, Weingast (1995), Qian and Roland (1996), Qian and Weingast (1996a), Shleifer (1996), Weingast (1995), and Wildasin (1996, 1997).

The Incentive Effects of Decentralized Information and Authority

Through the appropriate decentralization of information and state power, federalism can establish positive incentives to limit the state predation problem and negative incentives to reduce the soft budget constraint problem. In a dynamic setting, for example, the principal can sometimes increase efficiency by giving up some information and authority. Increasing *ex post* transaction costs may be essential for credible commitments and thus for *ex ante* efficiency.

The notion of increased efficiency through less information and limited authority differs from Hayek's idea. It has also been a consistent theme in the recent theory of the firm and regulation. Consider several examples. First, lack of commitment not to use ex post information creates the phenomena of "ratcheting up" planned quotas and inefficient regulation, leading to pervasive incentive problems (Laffont and Tirole, 1989). Second, in the theory of firm ownership, one cost of vertical integration is the lack of credible reward by the integrated firm to the manager when the former controls cost information (Riordon, 1990). For the same reason, inefficiencies arise with public ownership because of the government's superior information about the firm (Schmidt, 1996). Third, in an organization, reducing information channel linking lower decisionmakers to the top decisionmakers can be beneficial because it reduces wasteful influence activities (Milgrom and Roberts, 1990, 1992). Fourth, under certain circumstances, limiting the authority of the principal credibly provides a subordinate with the incentives to take "initiatives." These limits grants the subordinate more "real authority" through controlling more information despite her lack of "formal authority"

(Aghion and Tirole, 1997). Finally, diffused information and authority is also the key argument in the endogenous theory of hard vs. soft budget constraint (Dewatripont and Maskin, 1995).

Studies of federalism typically illustrate their principles using the state governments of the United States or the national and supranational governments of Europe. In addition to drawing on those cases, we believe that modern China provides a striking example of the economic benefits of federalism. China has emphasized economic reform through devolution of authority from the central to local governments, in contrast to the more centralized reform in Eastern Europe and the former Soviet Union. Along several critical dimensions, China's central government has explicitly limited its information as a way of credibly committing the center not to repeat the pernicious behavior of the Mao era. For example, the central government allows local governments to maintain various "extra-budget" and "off-budget" accounts. Limited knowledge about these budgets commits the central government not to tax them, which in turn encourages local governments to generate prosperity and revenue. The central government also issues large quantities of cash, facilitating cash transactions which are far less prone to state predation. Also, the state permits private savings accounts with state banks under false names, and thus credibly commits not to confiscate bank deposits for a particular person. Of course, the central government can still confiscate a portion of all deposits by taxation or inflation, but the political costs would be high. Although not completely binding its own hands, the central government's devolution of information and authority makes it harder to use those hands.

The allocation of authority also has profound implications for the hardness of budget constraints at different levels of government. McKinnon (1997) observes that American state governments are not only constrained in their taxing, but also more constrained in their borrowing than the federal government. Because the American federal government is backed up by the central bank (money issuing authority), therefore it can issue bonds at a privileged rate. No other financial institution or government can do this, implying that the federal government has a softer budget constraint. In comparison, the American states and local governments do not have direct access to the central bank. Nor, in contrast to Canada for example, do states have indirect access to the central bank through soft federal transfers to states. Furthermore, state borrowing is largely confined to issuing bonds for capital improvement, not general consumption. These limits have important incentive effects. They prevent states from endlessly bailing out ailing enterprises and from expenditure levels beyond their fiscal means. These limits therefore help preserve negative market incentives and provide local governments with the incentive to husband their economies.

This contrasts with the emerging federal system in the European Community. Because each European nation retains its own central bank, these "middle-level" governments have softer borrowing constraints. They may therefore bailout loss-making firms to a degree that American states cannot afford. The case of Canada is in between the United States and Europe. Canadian provinces do not have direct access to the central bank. Nonetheless, through the large transfers of federal revenue, provinces have indirect access to the central bank.[4]

4 Wildasin (1997) also studies central government grants to local governments for local public goods. He argues that a kind of externality arises in which large jurisdictions are more likely to face soft budget constraints than small jurisdictions. The reason is the “too big to fail” phenomenon that follows because the failure to bailout larger jurisdictions has far more severe consequences for the economy. Wildasin concludes that decentralization with smaller lower level governments leads to harder budget constraints.

The effect of decentralized allocation of information and authority in achieving credible commitment also helps explain why some local government owned enterprises perform better than state-owned enterprises (SOEs). Because the central government is concentrated with ownership and control of both industrial enterprises and banks, it is unable to credibly commit to high-powered incentives for enterprise managers. Without binding itself to any fixed rules, the state is always tempted to reduce rewards to enterprises and managers when it observes outstanding performances. Moreover, the state's knowledge of which state owned enterprises are ailing combines with its access to the central bank to imply an absence of commitment to a hard budget constraint. For this reason, governments of all stripes — including Western European or the former socialist — tend to bail out ailing national enterprises.

China's recent economic success provides an important contrast. Over the past fifteen years, local township and village enterprises (TVEs) have provided the engine of Chinese economic growth. These local government-owned enterprises have remarkably different governance structures from SOEs and thus face better positive and negative incentives (Che and Qian, 1997; Qian and Weingast, 1996b). By fully controlling the assets of TVEs, the local governments have access to information that not available to the central government, and thus they are able to resist state revenue predation in a credible way (for example, through revenue hiding). Moreover, because the local governments are empowered with the responsibility of local public goods provision, the state finds in its own interest to prey less on TVEs than on private firms because it expects some revenues to be used for local public goods provision. Most importantly, local governments' power is limited because they do not control state banks and cannot create money. This governance structure, where banks have credits but local governments have control and information over firms, serves as a commitment device to hard budget constraint in the way analyzed by Dewartripont and Maskin (1995).

The Incentive Effects of Jurisdictional Competition

Competition among jurisdictions forces governments to represent citizen interests and to preserve markets. In Tiebout, jurisdictional competition among local governments increases efficiency through sorting and matching. Our approach suggests that, in addition, jurisdictional competition serves as a disciplinary device to punish inappropriate market intervention by lower government officials.

Again, our argument here parallels those commonly made in the recent model about corporate control and the theory of the firm, which stress how markets encourage good behavior by corporate managers (Holmstrom and Tirole, 1989). For example, managerial labor market provides a degree of discipline because a manager who performs poorly is, among other things, more likely to receive low future wages. Competition in the product market also gives managers an incentive to pursue the shareholder interests of the firm. Finally, a number of economists have argued that the threat of a firm takeover in the capital market is the ultimate weapon against managerial misconduct.

Just as market competition pressures firm managers to reflect the interests of shareholders, competition among local governments helps limit government's predatory behavior. Mobile resources quickly leave jurisdictions with inappropriate behavior. Competition for mobile sources of revenue prevents local political leaders from imposing debilitating taxes or regulation (Buchanan, 1995; Weingast, 1995). In the best case, only those economic restrictions that residents are willing to pay for will survive. Examples of this effect abound in the literature. Romano's (1985) famous studies of corporate chartering in the United States explain how New Jersey emerged as the primary locus of chartering for major corporations late in the 19th century, but when that state moved to extract rents from these firms, a large number moved to Delaware, which has since remained the home of most large corporations.

Similar arguments also suggest how federalism's jurisdictional competitions leads to the endogenous emergence of harder budget constraints for lower governments (Qian and Roland, 1996). Politicians in every type of political system tend to bail out inefficient firms or spend on wasteful public consumption. In a federal system, however, the mobility of resources across regions raises the opportunity costs to local governments of bailing out inefficient firms or wasteful public expenditures. Ceteris paribus, jurisdictions that consistently make inefficient expenditures will not be able to attract mobile resources to jurisdictions. Therefore, competition endogenously hardens lower governments' budget constraints and changes the incentives of local politicians. In recent years, local governments' budget constraints in China have become harder, in part because local governments compete in spending their resources to attract foreign investments. They thus have higher incentives to stop subsidizing failing state firms.

A main concern about federalism is that, in the absence of centrally-mandated policies of redistribution, it may increase inequality across regions (for example, Rose-Ackerman and Rodden, 1997). The recent American South provides a complex illustration. The destructive

Civil War caused the South to fall from the richest American region to the poorest, and so it remained for many decades. Since 1950, however, the faster growth of the American South is at least partly the result of competition among southern state governments in offering flexible labor markets and less generous welfare provisions than the Northern states. This attracted investment on vast scale, along with help from factors such as the interstate highway system and the commercialization of air conditioning (McKinnon, 1995, 1997). Jurisdictional competition can therefore reduce regional inequality without centrally-mandated redistribution.[5] Moreover, as McKinnon suggests, the lack of federal redistribution may even be a necessary condition. In contrast to the American federal system, which has no strong tradition of revenue sharing or equalization grants from the federal government, regional equalization grants in Europe and Canada seem to have impeded this natural process of "equalization through competition." As McKinnon (1995, 1997) argues that, in the Mezzogiorno region of Italy and the poor maritime provinces of Canada, large intergovernmental transfers inhibit their labor markets from adjusting in the American mode.[6]

Sustainability of Federalism

To this point we have focused on how federalism helps a state credibly commit to preserving markets. For federalism to have this effect, however, it must be sustainable. To

5 Although jurisdictional competition allowed the south to catch up, federalism also allowed the pernicious Jim Crow system discriminating against African Americans.

6 Wildasin (1996) discusses the redistribution effect of factor mobility.

survive, federal systems require institutions that make them self-enforcing: political officials must have an incentive to abide by the rules of federalism. This issue is clearly outside the scope of first generation theories of federalism, but it is an important focus of the second generation theories. Recent formal models address this question by using repeated games (Bednar 1997, de Figueiredo and Weingast, 1997; Weingast, 1995, 1997). Page constraints limit our discussion to indicating but a few factors relevant for sustaining federalism.

Three decades ago, Riker (1964) suggested that federal systems were inherently unstable (see also Bednar 1997). DeFigueiredo and Weingast (1997) capture the problem in the two fundamental dilemmas of federalism: First, what prevents the central government from destroying federalism by overwhelming the lower governments? Second, what prevents the constituent units from undermining federalism by free-riding and otherwise failing to cooperate? Federal instability arises because the two fundamental dilemmas imply a tradeoff: institutions and powers designed to mitigate the first dilemma exacerbate the second, and vice versa.

Students of federal stability identify a number of considerations. We here note two.[7] First, the central government must be given sufficient resources to police shirking by lower governments; second, the lower governments must police central government abuse of its authority by retaliating in concert against abuses (de Figueiredo and Weingast 1997).

7 Other works address this question: Ordeshook and Svetsova (1997) and Riker (1964) emphasize the importance of political parties in limiting the encroachment of politicians. Bednar, Eskridge, and Ferejohn (1997) emphasize the national courts. Weingast (1997) discusses how a constitution can create a focal solution to certain coordination problems created by federalism.

We provide two brief illustrations of the second principle. First, Weingast (1998) stresses the importance of institutions to create a self-enforcing balance between state and national authority in the antebellum United States.[8] The "balance rule" constituted a critical institution for this purpose, giving both the north and the south an equal number of states. Both sections worried that the other would capture the national government, forcing bad policies on the other. Balance granted both sections a veto over national policymaking. In combination with the separation of powers system, balance helped keep most issues off the national agenda. The result was a strong system of market-preserving federalism, with the powers of the national government limited to providing national public goods, such as a stable monetary system, national defense, and policing the common market.

Recent events in China also reveal the importance of local government resistant against encroachment by the central government. Because federal institutions devolve authority, resources, and information away from the central government, they provide local governments with some incentives and tools to protect their newfound authority. Nonetheless, if lower governments fail to act in concert, the central government can encroach on the federal system. In China, for example, the central government tried to reverse local political authority underpinning market-oriented reform in the aftermath of Tiananmen Square in 1989. Led by

8 Weingast (1997) also discusses the importance of a focal solution to coordinate citizen and lower government retaliation for federal abuse of authority. From the beginning of the republic, Americans were deeply suspicious of the national government, preferring political power to be vested in state and local governments. Reflecting this suspicion, the two parties that dominated national elections during the first half of the 19th century — the Jeffersonians and, later, the Jacksonians — built their majority support in the nation on various notions of states' rights. Parties advocating a substantially greater political role for the national government could not compete in national elections.

the Governor of Guangdong, the governors of many provinces resisted so that the central government eventually backed down (Montinola, Qian, and Weingast 1995; Shirk 1993).

Conclusions

This paper attempts to sketch a new theory of federalism that complements traditional ones. We appeal to the theory of the firm to find a range of problems in federal systems ignored by traditional theories. Incentive problems, for example, occur throughout government hierarchies as in firms, even when public officials are motivated to serve others instead of being corrupt or malevolent. We argue that political institutions serve a similar role for government officials as firm institutions do for firm managers. Appropriately designed institutions help align the interests of public officials with citizens. Importantly, we also show that federalism helps government officials maintain the positive and negative incentives necessary for thriving markets.

References

Aghion, Philippe and Jean Tirole, "Formal and Real Authority in Organization," *Journal of Political Economy*, 105:1, 1-29, February 1997.

Bednar, Jenna. “Federalisms: Unstable by Design?” Paper delivered at the Conference on the Law and Economics of Federalism, University of Minnesota Law School, May 2 and 3, 1997;

Bednar, Eskridge, and Ferejohn, "A Political Theory of Federalism," WP, Hoover Institution, Stanford University, 1997.

Brennan, Geoffrey, and James M. Buchanan, *The Power to Tax: Analytical Foundations of a Fiscal Constitution.* New York: Cambridge University Press, 1980.

Buchanan, James, "Federalism as an Ideal Political Order and an Objective for Constitutional Reform," *Publius*, 25,2: 19-27, Spring, 1995.

Buchanan, James M., and Gordon Tullock. 1962. *The Calculus of Consent*. Ann Arbor: University of Michigan Press.

Che, Jiahua, and Yingyi Qian, "Institutional Environment, Community Government, and Corporate Governance: Understanding China's Township-Village Enterprises," *Journal of Law, Economics, and Organization*, forthcoming, 1997.

Coase, Ronald, "The Nature of the Firm," *Economica* 4, 1937: 386-405. Reprinted in Coase, R., *The Firm, the Market and the Law*, Chicago, University of Chicago Press, 1988.

Courant and Daniel Rubinfeld, "On the Welfare Effects of limited Taxation," . *Journal of Public Economics*, 289-316, 1981.

de Figueiredo, Rui J., and Barry R. Weingast, "Self-Enforcing Federalism: Solving the Two Fundamental Dilemmas," mimeo, Stanford University, April, 1997.

Dewatripont, Mathias and Maskin, Eric, "Credit and Efficiency in Centralized and Decentralized Economies," *Review of Economic Studies*, October, 1995.

Epple, Dennis, and Alan Zelenitz., "The Implications of Competition among Jurisdictions: Does Tiebout Need Politics?" *Journal of Political Economy*, 1981.

Frye, Timothy, and Andrei Shleifer, "The Invisible Hand and the Grabbing Hand," *American Economic Review*, 87:354-58, May, 1997.

Grossman, Sanford, and Oliver Hart, "The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration," *Journal of Political Economy*, 94, 1986.

Hayek, Friedrich A., "The Use of Knowledge in Society," *American Economic Review*, 1945, 35: 519-30.

Holmstrom, Bengt and Jean Tirole, "The Theory of the Firm," in R. Schmalensee and R. Willig (eds.) *Handbook of Industrial Organization*, vol.1, Amsterdam: North-Holland, 1989.

Inman, Robert P. and Daniel L. Rubinfeld, "The Judicial Pursuit of Local Fiscal Equity," *Harvard Law Review*, 92: 1663-1750, 1979.

Inman, Robert P. and Daniel L. Rubinfeld, "Rethinking Federalism," mimeo, UC Berkeley, March, 1997a.

Inman, Robert P. and Daniel L. Rubinfeld, 1997b. [Their Book MS]

Kornai, Janos, "The Soft Budget Constraint," *KYKLOS*, 39(1), 3-30, 1986.

Laffont, Jean-Jacques, and Jean Tirole, "The Dynamics of Incentive Contracts," *Econometrica*, 1989.

Musgrave, Richard, *Theory of Public Finance: A Study in Public Economy*, New York: McGraw, 1959.

McKinnon, Ronald, "Intergovernmental Competition in Europe with and without a Common Currency," *Journal of Economic Policy Modeling*, 463-78, October, 1995.

McKinnon, Ronald, "Market-preserving Federalism in the American Monetary Union," in *Macroeconomic Dimensions of Public Finance: Essays in Honour of Vito Tanzi*, M. Blejer and T. Ter-Minassian (eds.), London: Routledge, 73-93, 1997.

Milgrom, Paul, and John Roberts, "Bargaining Costs, Influence Costs, and the Organization of Economic Activity," in *Perspectives on Positive Political Economy* (J. Alt and K. Shepsle, Eds.) Cambridge, Cambridge University Press, 1990.

Milgrom, Paul, and John Roberts, *Economics, Organization, and Management*, Prentice Hall, 1992.

Montinola, Gabriella, Yingyi Qian, and Barry R. Weingast, "Federalism, Chinese Style: The Political Basis for Economic Success in China," *World Politics*, October, 1995.

North, Douglass, 1981. *Structure and Change in Economic History*. New York. Norton.

North, Douglass, *Institutions, Institutional Changes and Economic Performance*, Cambridge University Press, 1990.

North, Douglass C. and Barry Weingast, "Constitutions and Credible Commitments: The Evolution of the Institutions of Public Choice in 17th Century England," *Journal of Economic History*, 1989.

Oates, Wallace, *Fiscal Federalism*, New York: Harcourt Brace Jovanovich, 1972.

Ordershook, Peter, and Olga Svetsova, 1997. [paper on federalism and parties]

Qian, Yingyi, and Gerard Roland, "Federalism and the Soft Budget Constraint," CEPR Discussion Paper, No.481, Stanford University, 1996.

Qian, Yingyi, and Barry Weingast, "China's Transition to Markets: Market-Preserving Federalism, Chinese Style," *Journal of Policy Reform*, 1:149-185, 1996a.

Qian, Yingyi, and Barry Weingast, "Institutions, State Activism, and Economic Development: A Comparison of State-Owned vs. Township-Village Enterprises in China," chapter 9 in M. Aoki, H. Kim and M. Okuno-Fujiwara (eds.) *The Role of Government in East Asian Economic Development: Comparative Institutional Analysis*, Oxford University Press, pp.254-275, 1996b.

Riker, William, H., *Federalism: Origin, Operation, and Significance*, Boston, Little Brown, 1964.

Riordan, Michael, "What is Vertical Integration?" in M. Aoki, B. Gustafsson and O. Williamson (eds.) *The Firm As a Nexus of Treaties*, Sage Publications, 1990.

Romano, Roberta. 1985. "Law as a Product: Some Pieces of the Incorporation Puzzle," *Journal of Law, Economics, and Organization.* 1.

Rose-Ackerman, Susan, and Jonathan Rodden, "Does Federalism Preserve Markets?" mimeo, Yale University, 1997.

Schmit, Klaus, "The Costs and Benefits of Privatization," *Journal of Law, Economics and Organization*, 1996.

Schleifer, Andrei, "Government in Transition," mimeo, Harvard University, 1996.

Shirk, Susan, *The Political Logic of Economic Reform in China*. Berkeley: University of California Press, 1993.

Tiebout, Charles, "A Pure Theory of Local Expenditures," *Journal of Political Economy*, 64:416-24, 1956.

Weingast, Barry R, "Constitutions as Governance Structures: The Political Foundations of Secure Markets," *Journal of Institutional and Theoretical Economics*, 149, 1993.

Weingast, Barry R, "The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Growth," *Journal of Law, Economics and Organization*, 11: 1-31, 1995.

Weingast, Barry R. "Political Foundations of Democracy and the Rule of Law," *American Political Science Review* (1997) 91: 245-63.

Weingast, Barry R. American Democratic Stability and the Civil War: Institutions, Commitment, and Political Behavior," in Robert Bates, et. al., eds. *Analytic Narratives*. Princeton: Princeton University Press (forthcoming, 1998).

Wildasin, David E., "Factor Mobility and Redistributive Policy: Local and International Perspectives," mimeo, Vanderbilt University, December, 1996.

Wildasin, David E., "Externalities and Bailouts: Hard and Soft Budget Constraints in Intergovernmental Fiscal Relations," mimeo, Vanderbilt University, 1997.

Williamson, Oliver, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*, New York: The Free Press, 1985.

Williamson, Oliver, "The Institutions and Governance of Economic Development and Reform," chapter 13 in his *The Mechanism of Governance*, New York: Oxford University Press, 1996.