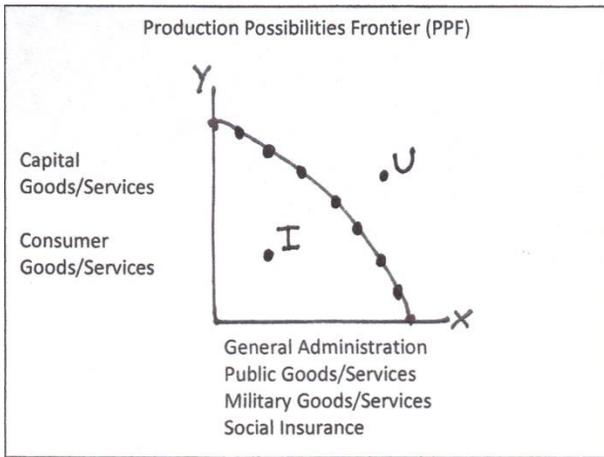


Chapter 5 Vertical Federalism

Applied Constitutional Capitalism

The ordering principle of a nation is hierarchy. The United States enjoys a constitutional republic, where the people elect representatives to positions of governance who administer the general rules of the game and general administration, provide public goods and services, provide military goods and services, and provide social insurance. These are found on the X Axis of *Figure 5.1*.



(*Figure 5.1*)

The proceeds and profits of the goods and services produced and consumed on the Y Axis are taxed and redistributed to pay for the class of goods, services, and social insurance on the X axis.

Figure 5.1 represents the national productions possibility frontier of the United States. This productions possibility frontier was constructed by identifying the specific constitutional authorizations into economic activity that establish general administration, public goods and services, military goods and services. Further consideration was given to the statues, administrative regulations, and judicial precedence which authorize the provision of social insurance.

All of this needs to be paid for, which is possible through the production and consumption of capital goods and services and consumer goods and services.

Throughout the United States, the production of capital goods and services, and consumer goods and services occur. Throughout the federal system of the United States local governments and municipalities, states, and the federal government provide goods and services that require taxation and redistribution to pay for them. This chapter will examine this process at each level of government and make recommendations on how to expand the production possibilities frontier at each level of political economy in the United States.

Vertical Federalism at the Local Level

As Alexis De' Tocqueville noted **“to study the Union before studying the state is to follow a path strewn with obstacles¹”**.

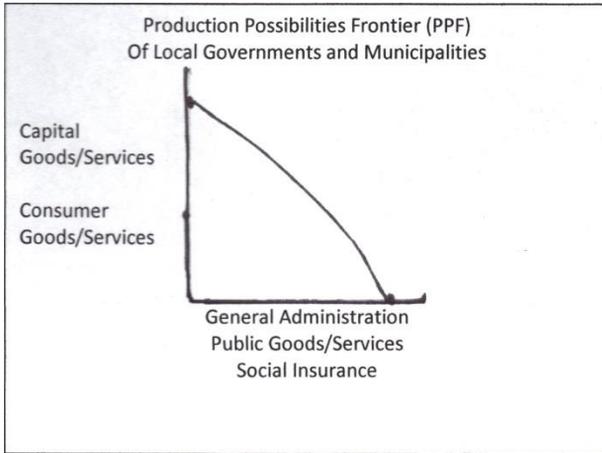
Remember it was the states/colonies that ratified the U.S. Constitution and established the federal system.

“The states which now compose the American Union all have institutions with the same external aspect. Political and administrative life is concentrated in three active centers, which could be compared to the various nervous centers that control the human body. The township is first in order, then the county, and last the state²”.

Think of your Local Township, village, city or county. There are local capital goods and services, and local consumer goods and services that are taxed and redistributed to pay for the general administration, public goods and services, and possibly forms of social insurance your locality provides. As illustrated in *Figure 5.2*

¹ (De'Tocqueville, 1848, p. 61)

² (De'Tocqueville, 1848, p. 61)



(Figure 5.2)

Vertical Federalism is the method by which Constitutional Capitalism can be implemented to expand the production possibilities frontier at your local level by improving the rules of the game, to promote increases in capital stock, increases in resource availability, and increases in technological innovation. (This is the arena in which one will first encounter factionalized rent seekers and factionalized socio-ethical-humanitarians.)

The first area of focus on your local level is the budget. The budget is an economic document by virtue of a budget being an allocation of scarce resources. Your local budget identifies the costs associated with general administration, public goods and services, and social insurance if your locality provides it.

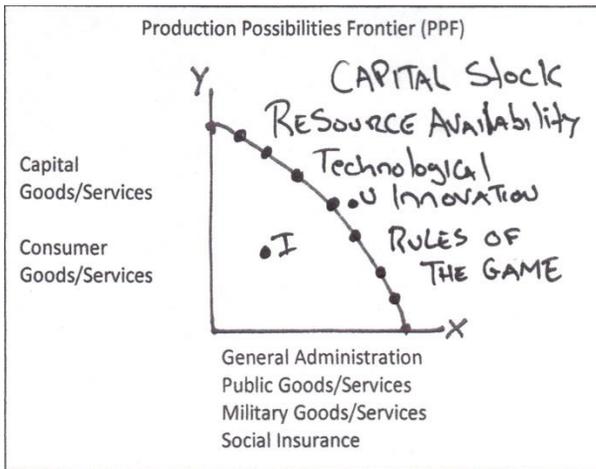
The second areas of focus on your local level are the taxes and fees that fund the budget. Taxes are economic by virtue of taxes imposing elasticity on prices, costs, and values.

The third area of focus on your local level is the performance of the budget in providing general administration, public goods and services, and social insurance if applicable.

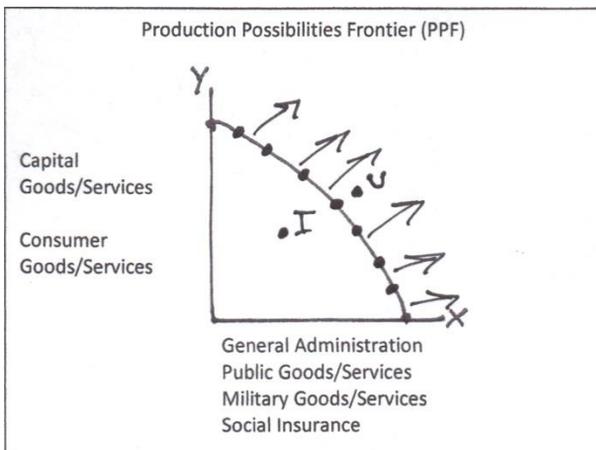
The fourth areas of focus at your local level are the zoning laws, comprehensive plans, and local ordinances.

Becoming familiar with these four areas of focus on your local level will give you a general idea of how the local rules of the game impact, increases in capital stock, increases in resource availability, and increases in technological innovation. You will also quickly discover whether your local elected officials and public administrators have any degree of competence and professionalism.

You will already have a significant advantage over your local officials by understanding that improvements to the rules of the game can increase capital stock, increase resource availability, and increase technological innovation, which expands the production possibilities frontier resulting in economic growth. (Figure 5.3) and (Figure 5.4)



(Figure 5.3)



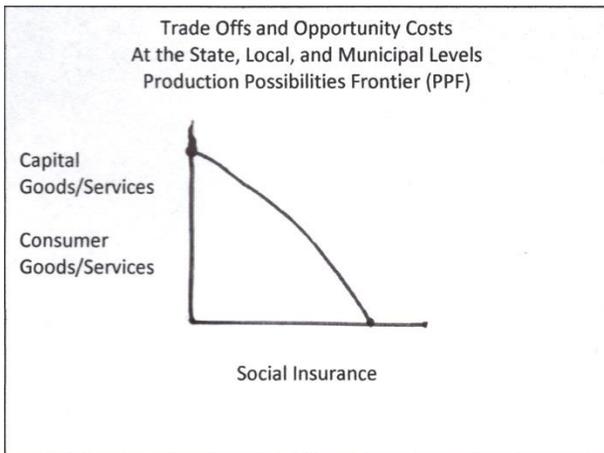
(Figure 5.4)

You will quickly be able to identify those who espouse the dogma of market failures, externalities, inequality, and redistribution amongst the public official and the public at large.

Understanding the formula for economic growth, you will be able to identify those who promote economic development for exactly what they are: political panderers who haven't the slightest grasp of basic economic principles.

You will be able to identify when they are speaking about market failures, externalities, inequalities, and redistribution. You'll be able to witness first-hand how thin and weak these arguments really are. These arguments are accepted as conventional wisdom and an acceptable narrative only because nobody challenges them in a thoughtful and tactful way.

The identification of the tradeoffs occurring at the local level is a very important weapon in the arsenal of a Constitutional Capitalist.

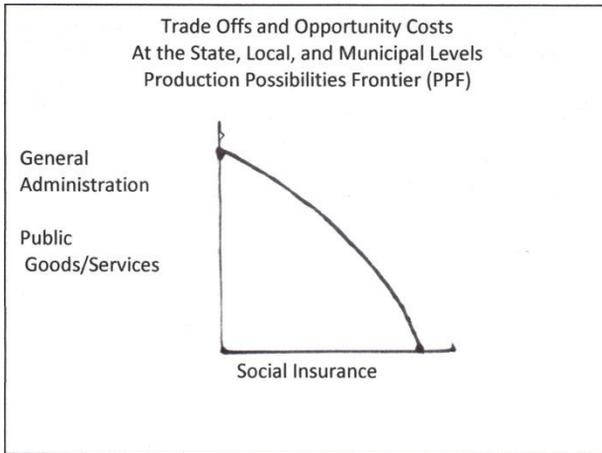


(Figure 5.5)

It is critical to identify where the budgets and taxes at the local level are having a negative impact on the expansion of capital goods and services, and consumer goods and services, due to the increased cost of providing social insurance. (Figure 5.5) It is then appropriate to study the local official's arguments about the costs of social insurance and how they are helpless to anything about it. This is an area to

advance changes in the rules of the game to expand the productions possibilities frontier.

The next set of tradeoffs that is critical to identify at the local level are the increasing costs of social insurance not only having a negative impact on the expansion of capital goods and services, and consumer goods and services, but also having a negative impact on the general administration and provision of public goods and services at your local level.



(Figure 5.6)

(Figure 5.6) illustrates the increasing cost of social insurance requiring the amount of public goods and services, and general administration, to be impacted due to the scarcity of resources. This tradeoff is occurring at your local level, in your local budget. It is necessary to discuss these tradeoffs and the opportunity costs associated with, how much money is being spent on social insurance that could be used to repair local roads, bridges, and other vital public works in the community that are neglected due to the lack of funds. This is a serious discussion that should begin by identifying where improvements can be made to the rules of the game specifically to increase capital stock, increase resource availability and increase technological innovation.

One of the most difficult challenges I find speaking at public meetings is not sounding like a complete idiot. So it is worth it to go to several meetings before speaking, gather intelligence and get

yourself oriented to the forum, where the microphone and podium are, where the cameras and lights may be, before you stand up and publically make your case. You have to do your research so you can hit them as hard as you can in areas where you are strong and they are weak.

They may know more about the details of the budget than you do. Yet if you know more about the concept of elasticity, and how behavioral responses often make *ceteris paribus* (other things constant) assumptions invalid in the cases of projections and forecasts of revenue increases and decreases related to increases and decreases of tax rates, they cannot touch you. They will make ambiguous statements and thank you for coming out and participating in the community.

This is how a constitutional capitalist on the local level becomes emboldened!

As a personal example, one year I started four fights with my local town and county officials. One was that town supervisors have been claiming an 18% unemployment rate in the town over a period of five years with no empirical evidence or data to back this figure up. I did my research and called them out on it in the local paper and to their faces at a local town board meeting. The second example was the local desire to win a casino in the town. Public officials from the town and county, as well as casino oligopolists claimed job creation and tax relief. Yet when I've called them out to quantify these claims by releasing the capital budgeting decision methods and details of the project labor agreements in the local paper and to their faces at town board meetings no one would produce them. The third example was of contamination in the local area documented in a United States Geological Survey report, which no one seems to have read before a buyback program was implemented which included the signing of health releases. The final example was the dysfunctional & inefficient county budget, which is produced in a departmental line item format that is distributed in the form of a 500+ page flip book.

The opportunities to participate in vertical federalism to advance constitutional capitalism are endless. It is not my place to

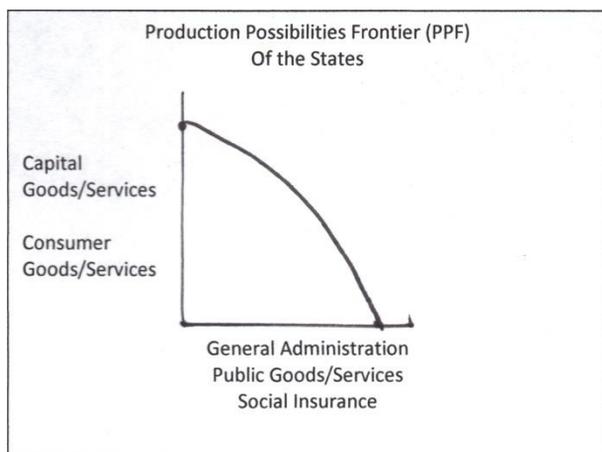
make a list of items and say they should be handled in such and such a manner. Every locality is unique and everyone has different strengths. Fight the battles you can win. Find like-minded members of the community who can advance the fight in different areas than you can.

Those at the local level are the ones seeking to move up to the state level and the federal level. If they are no good at the local level they need to be stopped at the local level and replaced. This is why I call it Vertical Federalism. Constitutional Capitalism can only be implemented from the bottom up, not from the top down.

Vertical Federalism at the State Level

Vertical Federalism at the state level is something that cannot exist without vertical federalism occurring in a majority of the towns, villages, cities, and county's within a given state. Once constitutional capitalists begin using vertical federalism in their local governments, it will quickly become clear that many of the dilemmas the local governments face are created by the policy implementations of the state. Constitutional capitalists and vertical federalists must do the best they can to make improvements to the rules of the game at the local level, and begin proposing improvements to the rules of the game at the state level.

The name of the game is the expansion of the state's productions possibility frontier through improvements in the rules of the game that increase capital stock, increase resource availability, and increase technological innovation in order to promote economic growth.



(Figure 5.7)

Obvious areas of focus include budgets, taxes, fees, and the performance thereof. There are several other areas at the state level where improvements to the rules of the game can expand the production possibilities frontier. (Factionalized rent seekers and factionalized socio-ethical-humanitarians are entrenched at the state level)

Market Structure is a significant area for improvement to the rules of the game. It is important to identify what industries and sectors of the economy; the state has used the rules of the game to establish monopolies, monopolistic competition, differentiated oligopolies, and oligopolies.

Statutes and Administrative Regulations are another potential treasure trove of economic malpractice committed by the state. The vast majority of statutes and administrative regulations implemented by the states will be based on the dogma of market failures, externalities, inequality, and redistribution.

Public Goods and Services are an essential area that requires scrutiny from constitutional capitalists. The focus should be on implementing policies that enable the pure public goods, the pure public services, and the impure public goods of a state to be delivered in the most efficient and cost effective way possible, while maintaining a high quality product or service. In the case of impure public services, the identification of the crowding out phenomenon associated with injection of public money and investment should be scrutinized to determine if the private sector would crowd in with private money and investment, if the government stopped providing the impure public service.

Economic Development versus Economic Growth is a very important argument that must be had at the state level. Many states have implemented economic development policies that filter down through the counties, municipalities, and towns. There is a significant difference between economic development and economic growth. Economists who specialize in economic development analyze changes in the standard of living in medium to low income countries³. At the State & Local level in the U.S. economic development is often focused on improvements to infrastructure, education, health care, and other public goods and services. Moral and ethical judgments lead toward a social equality element in some economic development programs. What tends to occur is that an expansion of public goods and services, and social insurance is justified through economic development

³ (Grant, 2007, p. 473)

programs based on the public finance dogma of market failures, externalities, redistribution, and inequality. Economic development is problematic because it attempts to reallocate resources toward the X axis of the PPF, while redistributing the pie, without growing or expanding the pie.

Economic growth on the other hand is defined as an expansion of the production possibilities frontier⁴. Instead of the state dictating an economic development program to the counties, municipalities, and towns; the towns, municipalities, and counties ought to be using the concept of PPF expansionism at each of their respective levels in order to lead the state toward a program of improving the rules of the game to expand the PPF of the state.

As improvements to the rules of the game in the areas of budgets, taxes, market structure, statutes and administrative regulations, and public goods and services, are implemented, it will become clear that many of the dilemmas facing the state are the result of federal policy implementations. As constitutional capitalists implement a program of vertical federalism throughout the towns, villages, cities, counties, and states, an opportunity will exist for constitutional conventions to be held in the states. State constitutional conventions are the ultimate goal in improving the rules of the game, in order to expand the production possibilities frontiers of the states.

It is in state constitutions, where many of the obstacles to economic expansion rooted in market failures, externalities, inequalities, and redistribution, are codified. Obstacles to increasing capital stock, increasing resource availability, and increasing technological innovations, in the forms of social insurance, impure public services, as well as cumbersome procedures, are codified in state constitutions. The focus of constitutional capitalism and vertical federalism is improving the rules of the game. In order for the rules to be improved state constitutional conventions are ultimately necessary.

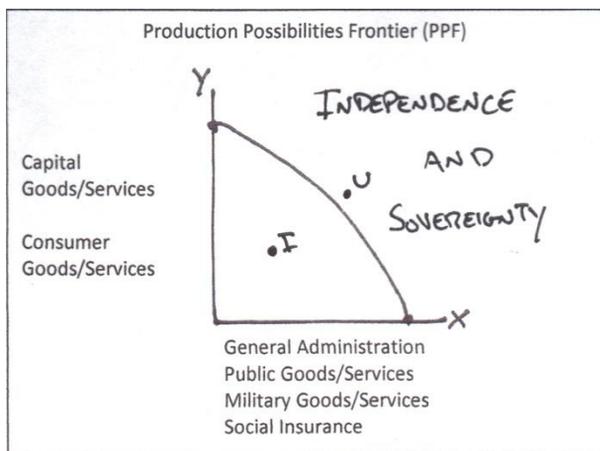
⁴ (Schiller, 2009, p. 12)

As the method of vertical federalism advances the constitutional capitalist concept of production possibilities frontier expansionism through the states, state legislatures and governors' mansions will begin to reflect this new paradigm of political economy. As the composition of state legislatures and governorships change, so too will the composition of the national legislature begin to change in order to reflect the population it represents.

Vertical Federalism at the Federal Level

In order to arrive at the top, the journey must begin at the bottom. Supposing an arrival of constitutional capitalists at the top, resulting from implementing constitutional capitalism using the method of vertical federalism along the way, it is necessary to consider for a moment what that would look like. The localities and the states would be operating in a manner that would have improved the rules of their games, in order to expand their production possibilities frontiers, thereby expanding the production possibilities frontier of the United States as well.

Constitutional Capitalism is a system of checks and balances that, checks expansion of the production possibilities frontier to the U.S. Constitution, and balances this expansion to the independence and sovereignty of the United States to none are traded off, sacrificed, or compromised for the sake of another. (Figure 5.8)



(Figure 5.8)

The main obstacle to implementing Constitutional Capitalism through a program of bottom up Vertical Federalism is the 17th Amendment. This is why it is so important to begin at the local levels and work up to the state level all across the United States. If constitutional capitalists hold office in the localities, states, and begin making incursions into the national legislature, it will be possible to repeal the 17th Amendment.

The direct election of senators allows the national political parties to establish a lock on their power. The potential for each Senate race to become a national election, with out of state money pouring in from super political action committees, special interest groups, and the national committees; the people are less likely to be represented in accordance with their preferences than if the state legislature appointed senators.

“It is equally unnecessary to dilate on the appointment of senators by the State Legislatures. Among the various modes which might have been devised for constituting this branch of government, that which has been proposed by the convention is probably the most congenial with the public opinion. It is recommended by the double advantage of favoring a select appointment, and of giving to the State governments such an agency in the formation of the federal government as must secure the authority of the former, and may form a convenient link between the two systems”. ⁵

James Madison found the method of appointing senators by the state legislature to be the most congenial with public opinion. It makes sense if you are oriented to a bottom up approach as opposed to a top down approach. It was the states that ratified the constitution, so the method of appointing senators in the state legislature was one of the ways the states were able to maintain their authority within the new federal system.

“In this spirit it may be remarked, that the equal vote allowed to each state is at once a constitutional recognition of the portion of sovereignty remaining in the individual states, and an instrument for preserving that residuary sovereignty. So far the equality ought to be no less acceptable to the large than to the small states; since they are not less solicitous to guard, by every possible expedient, against an improper consolidation of the States into one simple republic.

⁵ (Madison, Federalist 62 The Senate)

Another advantage accruing from this ingredient in the constitution of the Senate is, the additional impediment it must prove against improper acts of legislation. No law or resolution can now be passed without the concurrence, first, of a majority of the people, and then, of a majority of the States".⁶

The 17th Amendment has stripped sovereignty from the states, consolidated the states into a simple republic, and removed an impediment to improper acts of legislation. Madison describes the federal government as a majority of the people and a majority of the states. It is important to ask oneself if the majority of legislation being produced in the Congress reflects the majority of the people in the House, and the majority of the States in the Senate. The majority of the legislation produced today reflects the will of the parties in control of the House and Senate.

This is the root of the top down federalism that is destroying the political economy of the United States.

"The State governments may be regarded as constituent and essential parts of the federal government; whilst the latter is nowise essential to the operation or organization of the former. Without the intervention of State legislatures, the President of the United States cannot be elected at all. They must in all cases have a great share in his appointment, and will, perhaps, in most cases, of themselves determine it. The Senate will be elected absolutely and exclusively by the State legislatures".⁷

One of the reasons the implementation of Constitutional Capitalism must occur through a program of bottom up Vertical Federalism beginning at the local level and advancing to the States is because of the 17th Amendment. In order to repeal the 17th Amendment the State legislatures have to be emptied of those belonging to the two national political parties in control of every level of government. If the Constitutional Capitalists can win town, municipal, and county elections, and govern in a manner that expands the local PPF's, they will be in a position to recruit other

⁶ (Madison, Federalist 62 The Senate)

⁷ (Madison, Federalist 45)

Constitutional Capitalists to take their place as they advance to State legislatures. As local and State districts are composed of Constitutional Capitalists, so to can Congressional districts be competed for.

The significant disorientation of basic ordering principles begins to occur just over a century ago with the passage of the 16th Amendment, the Federal Reserve Act, and the 17th Amendment. The 16th Amendment established the income tax which is the bedrock foundation of contemporary fiscal policy. The Federal Reserve Act established the Federal Reserve System which is the bedrock foundation of contemporary monetary policy. The 17th Amendment allowed the States to become **an improper consolidation of the States into one simple republic** that James Madison warned against in *Federalist 62*.

Article 1 Section 8 of the constitution makes clear that Congress has the authority to tax and spend (fiscal policy), as well as coin money and regulate the value thereof (monetary policy). In that sense there exists a legitimate constitutional foundation for establishing an income tax and a central bank. Given the legitimate constitutional foundations, it is completely legitimate to question whether a proportional flat income tax is more efficient than the current system of progressive income taxation. It is also legitimate to specifically question the role of the central bank's open market operations, and whether or not it is an appropriate method to "regulate the value" of interest which is delegated to Congress.

Given **the improper consolidation of the States into one simple republic**, under the 17th Amendment, we can now see what occurs when an additional impediment **against improper acts of legislation** is removed.

Social insurance programs with exponential growth of cost and debt are implemented.

The ability to borrow money on the credit of the United States is expanded to over \$17 trillion.

Uniform laws on the subject of bankruptcies and uniform rules of naturalization are ignored.

The infrastructure of the United States is deteriorating and crumbling.

Trade deals that sacrifice and compromise American independence and sovereignty are implemented.

Commerce becomes regulated in a manner that deteriorates the rules of the game by restricting increases in capital stock, increases in resource availability, and increases in technological innovation, due to the dogma of market failures, redistribution, externalities, and inequality.

Capital flees the United States, and instead of expanding the production possibilities frontier of the U.S., the production possibilities frontiers of emerging markets are expanded, or in other cases, capital is withheld for the sake of earning interest until the rules of the game improve in the U.S., or an opportunity to invest somewhere else is discovered.

These and other pressures on the production possibilities frontier cause the economy, the constitution, and our independence and sovereignty to be sacrificed and compromised.

And for what?

Market Failures that do not exist and a significant disorientation from basic ordering principles by those who support, and those who control the failed two party political system.

(Factionalized Rent Seekers & Factionalized Socio-Ethical-Humanitarians)

The long term goal of bottom up Vertical Federalism is to win as many local elections as possible, gain at least 1/3 of the seats in 2/3's of the State legislatures, and gain 1/3 of the seats in the House and the Senate.

Armed with the principles of Constitutional Capitalism, the truth about market failures and a program of bottom up Vertical Federalism, the time to start is now.

The question I posed in Chapter 2 of *Constitutional Capitalism and Common Defense* **is still open.**

The fundamental economic question for the United States in the early 21st century is: what rate of exponential economic growth is needed by the class of private goods on the Y axis to offset the exponential rate of growth in debt and costs of the class of public goods on the X axis?