

A SIMPLE DECISION RULE FOR JURISDICTIONAL ISSUES

John Haring
Strategic Policy Research, Inc.

An important subtext in these analyses of how to draw economically rational jurisdictional boundaries for regulation involves tactical questions of which assignment of authority is likely to lead to efficiency-enhancing regulatory reform. According to Megdal, given uncertainty, differences in consumer tastes, and geographic variation in the extent of and potential for competition, experimentation with a diverse set of approaches in the laboratory of the states is preferred. Egan and Wenders argue that these state laboratories are metaphorically populated by cranks and mad scientists so that, a little paradoxically, the best way to get to truly decentralized (*viz.*, market) decision making is to centralize authority at the federal level and then have federal regulators forebear from exercising that authority.

The latter is a seductive approach, which may, in fact, hold the greatest hope of success. The problem with it is whether federal officials can actually be trusted not to exercise power once they have acquired it. Considerations related to preferences for risk bearing buttress this concern with respect to reliance on a friendly, federal Leviathan (Posner, 1982).

Regulatory capture generally requires an investment of resources to meld a controlling coalition of interests. The costs of forming a coalition vary directly with the size of the relevant polity because costs rise with the number of interests that must be reconciled. This implies that the costs of creating and maintaining an effective coalition will generally be greater at the federal level than at the state level and, therefore, the probability of forming such a coalition at the federal level will be smaller.

On the other hand, intuition suggests that the return from successfully forming an effective coalition will usually be greater at the national level. Expected losses from regulatory capture depend on both the magnitude of the losses incurred in the event of capture and the probability that capture will actually occur. Suppose that expected losses were the same at the state and federal levels of government. Because expected losses at the federal level reflect smaller probabilities of larger losses, the risk averse will attach greater disutility to that outcome than to an actuarially equivalent outcome involving larger probabilities of smaller losses. Risk aversion implies that the relative certainty of smaller losses is preferred to the uncertain (i.e., risky) prospect of potentially large losses. Assuming that citizen-consumers are generally risk averse, decentralization of decision making is preferred.

Megdal identifies a variety of other considerations that argue for state regulation. These include the superior ability of state decision makers to produce and utilize relevant information based on their closer proximity to the people affected by their decisions and the aforementioned desirability for diversity and experimentation where there is uncertainty and given differences in tastes for public goods like regulatory policies (which are nonrivalrous in consumption and non-exclusive). An additional consideration is opportunity for competition among the states and the effectiveness of so-called "voting with your feet" to supply a control on governmental power and behavior. Individual and corporate citizens may be able to shape governmental policies by their decisions to enter or exit a particular jurisdiction. In this way, governments may be constrained by actual or potential competition from other governments for citizens.

The requirements for effective jurisdictional competition bear a close resemblance to those typically posited as requirements for optimal market organization (Bator, 1971; Mueller, 1991). Both require resource mobility, a large number of alternative substitutes, contractual or legislative freedom, and, importantly, the absence of important external effects. Failure of this last condition to be satisfied is the major flaw in the intellectual case for decentralization in markets or governments. Notwithstanding the benefits of competition (jurisdictional or otherwise), there is a clear danger in drawing jurisdictional boundaries (or contracts) too narrowly. In particular, when decision makers take decisions that affect third parties who are not parties to the decision, they may fail to account adequately for effects on these parties.

The economic desirability of internalizing these external or extrajurisdictional effects is the principal rationale for federalization of decision making and presents the fundamental problem for a federal system of governance—how can the preference for decentralized decision making be reconciled with the adverse consequences flowing from policies that ignore important economic interdependencies linking those within and those beyond the boundaries of the decision makers' jurisdiction? Logically, external effects may be internalized by redrawing jurisdictional boundaries so that what was once external becomes internal. The Su-

premacyp Clause of the United States Constitution, when exercised in conjunction with other powers, provides Congress and the Judiciary with a means of redrawing jurisdictional boundaries so that such internalization takes place. Federal regulators exercise this option through their use of preemption.

Internalization of jurisdictional externalities is not a free good. Its costs include the loss of the advantages that more decentralized decision making can bring. These advantages are necessarily forfeited when jurisdictional boundaries are enlarged. But leaving telecommunications policy decisions entirely to state commissions is also unlikely to lead to optimal results. Such action would impose the costs created by each failure to internalize relevant jurisdictional externalities. The important point is that because there are trade-offs between the advantages of both centralization and decentralization, an optimal allocation of decision-making authority may be one in which both the state and the federal governments retain some power to set policy.

In telecommunications, the extrajurisdictional effects that provide the economic rationale for federal preemption of state authority lie principally in economic interdependencies based on complementarities in production and consumption. These complementarities are ubiquitous and occur on both the demand and supply sides of the relevant economic markets.

From an economic standpoint, state actions in regulating intrastate common carriage may adversely affect interstate common carriage, or more generally, interstate commerce. The fact that different equipment can be used to provide interstate and intrastate services or that accounting rules can be fashioned to permit the separation of jointly used equipment in arbitrary ways for regulatory purposes is economically irrelevant. Where there are cost or demand complementarities, actions that affect one side necessarily affect the other. That inputs or outputs are physically, fiscally, or conceptually separable does not alter this fact. Not does it alter the fact that policy rules that fail adequately to recognize the existence of such economic interdependencies will also fail to maximize economic welfare.

Levitz and I (Haring & Levitz, 1989) proposed the use of an "extrajurisdictional effects" test for assignment of jurisdictional authority in telecommunications. Under this test, states would retain all power to regulate intrastate telecommunications as long as their exercise of that power did not impose external effects on persons outside of state boundaries. Under our proposed approach, the FCC would make an initial determination of whether a state regulatory policy related to intrastate common carriage failed to internalize economically relevant (i.e., nonpecuniary) external effects and consequently should be preempted. Appellate courts would review that decision. We believe it would be relatively easy to harmonize this kind of rule with the traditional approach to statutory interpretation and supplied the details of a proposed harmonization in that paper.

Our approach would, in principle, leave much authority to the states and thus potentially leave some scope for experimentation, diversity, and competition

among the states, which are the strengths of a decentralized system. At the same time, precisely because telecommunications is an activity where there are liable to be pervasive extrajurisdictional effects, our approach may lead to extensive federal preemption if state power is not exercised responsibly. But that is as it should be if we take externalities and the desirability of internalizing them seriously. When the wires are strummed in one place, they tend to vibrate everywhere else.