The Daily Dish

Regulatory Federalism

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Eakinomics: Regulatory Federalism

Much has been made — including in Eakinomics — about the dramatic change in the trajectory of federal regulation under the Trump administration. In an interesting development, CNBC is reporting that — at least in the area of financial regulation — states are announcing their desire to offset in their jurisdictions any rollback in the Dodd-Frank regulatory apparatus. Obviously, this represents a difference in policy preferences — no news there. But it also represents a very different strategy for policy implementation. How should one think about it?

The closest research analogy is fiscal federalism. In this framework for policy, responsibility for the provision of a public good is assigned to the government that has the same geography as the benefits of that public good. So, for example, the federal government should provide national security because, once it is provided, it benefits every citizen equally. At the other end of the spectrum is a public park that is provided by the community government whose residents visit and enjoy the park. In between, for example, could be water pollution controls that protect the integrity of a multi-state watershed. Obviously, this is a conceptual framework; in actuality the goal is simply to get things assigned to federal, regional, state, and local entities in some sort of rough justice fashion.

Using this framework, the key takeaway is that the benefits of sound financial market regulation extend nationally; indeed one could argue that they are global. (The latter point is highlighted by the tensions that arise out of initiatives by international bodies such as the Financial Stability Board.) One would never argue that they are demarcated state by state. Nonetheless, CNBC notes, “In July, Nevada put brokers working in the state under a fiduciary standard that they must give advice in a client’s interest, and the state’s securities regulator is now working on the details of that rule.” It simply makes no sense — and will be very costly — for the nature of advice, products, and retirement savings incentives to change state by state.

The development puts Congress in a delicate position. It could preempt by legislation the ability of states to regulate in these areas. That would provide a uniform regulatory framework. At the same time, however, it represents an expansion of federal power at the expense of the states — potentially in violation of the spirit of the 10th Amendment