

Federalism and Technological Innovation: The Impact of Fintechs on the Dual Federalist Model

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Abstract

This article analyzes the historical aspects that structure the foundations of classical federalism, as well as its origin, development in the United States of America and its transplantation to Brazil. The work also intends to discuss the importance of current technological companies as digital platforms and innovative data processing techniques and their barriers encountered in the face of a dual federalism presented by the federal and state models. Therefore, the study was guided, predominantly, through bibliographic research related to the legal area, with basis in national and foreign doctrines, through interdisciplinary investigation of a legal-theoretical type.

Key words: Origins of federalism; American federalism; Fintech

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1. INTRODUCTION

Federalism is characterized by a mechanism for distributing state power among various entities in a given territory.

The US experience, the first federalist in the world, established a bold institutional mechanism, which made

it possible to simultaneously overcome the shortcomings of the confederative model of organization and implement a system in which political power would also be shared and rationally limited by the provision of competences between the federal and state decision-making spheres.

This formula recognizes the concomitant existence of two spheres of political power over the same territory, each protected by different themes and governed by a single written and rigid text: the Constitution.

More than two hundred years on from its consolidation by the Founding Fathers in the American Constitution of 1787, classic federalism has now been transmuted, presenting various subcategories in order to make it viable, given the political, social and economic context of a given federal state, e.g. cooperative, fiscal and health federalism.

Despite their variations, all types of federalism seek in common to entrench in a state the principles of non-division and the distribution of legal and territorial competences with the aim of constituting a strong national state *vis-à-vis* other nations.

This article aims to develop the idea of the new fintech federalism, examining how its disparate set of legal experiments can revolutionize the financial regulation of a given state.

In this sense, this study will analyze the historical aspects that structured the foundations of classical federalism as a constitutional principle of a composite state, as well as its origin and development in the United States.

Finally, the paper also aims to discuss the importance of today's technology/finance companies as digital platforms and innovative data processing techniques and the barriers they face in the face of cooperative federalism.

To this end, the study was guided predominantly by bibliographical research related to the legal area, as well as national and foreign doctrines, through interdisciplinary research of a legal-theoretical type.

2. CONSTITUTIONALISM AND FEDERALIST POLITICAL ORGANIZATION

By tracing a timeline over the last few centuries, it is possible to see that constitutionalism is the practical result of a series of movements that fostered the central idea of rationalizing and limiting the exercise of the ruler's power, by providing for rights and guarantees enshrined in laws and declarations.

In a brief analysis, these movements encompass various philosophical, political and social currents that were based in 17th century England, together with the emergence of the Bill of Rights, and intensified at the end of the 18th century, mainly due to the French Revolution (1789-1799) and the promulgation of the 1st Constitution of the United States of America.

These currents had as their exponents some of the most important modern thinkers known worldwide, such as John Locke, Montesquieu and Rousseau, influencers of the liberal thought that made it possible for absolutist regimes to fall through the conception that people have enough self-determination to, in a collective pact, give up certain rights and freedoms in order to constitute a government invested through voluntary adherence and no longer by force.

As an illustration, Miranda (2008, p.96) accurately expresses the paradigmatic shift that led to the phenomenon under analysis:

Instead of tradition, the social contract; instead of the sovereignty of the prince, national sovereignty and the law as an expression of the general will; instead of the exercise of power by one, the exercise of power by many; instead of subjects, citizens, and the attribution to all men, just for being men, of rights enshrined in the laws.

But, after all, what constituted constitutionalism and to what extent is its presence still important for today's democracies? From a theoretical point of view, constitutionalism is a multifaceted concept, in that it can be understood from more than one angle. For example, it recurs from cultural, historical and normative-dogmatic perspectives.

In this respect, Häberle (2006, pp.37-62) considers constitutionalism to be a "culturally and historically conditioned process through which it is possible to limit substantive state power to rationally agreed rules and rites". On the other hand, Bastos (2010) considers constitutionalism to be a "social phenomenon essentially endowed with a legal character".

Authors such as Miranda (2008) argue that constitutionalism was a movement directed against monarchical absolutism, with the aim of limiting state power by sharing the exercise of sovereignty with Parliament, with the essential aim of organizing a vital process of freedom.

However, despite the various perspectives of approach, based on the references mentioned above, it is possible to

trace common characteristics regarding the emergence of the constitutionalist movement. That is to say, although they express different finalistic visions of the concept of the constitutional phenomenon, there is relative convergence on its determining reasons.

According to Miranda (2008, p.98), "although conceived in rational and even desirably universal terms, [constitutionalism] in its historical realization cannot be detached from a certain socio-economic and socio-political situation".

As a rule, the historicism of the constitutionalist movement highlighted by Miranda (2008) is understood as a functional element of a broad socio-cultural process of spreading ideals that aimed to establish a process of "rational domestication of power" as an anthropological premise for safeguarding human dignity.

In this respect, by claiming to legitimize the control of state power to a fundamental consensus, constitutionalism presents unique conditions of sustainability, conditioned to the practical result of the arrangement of social and historical variables present in a particular way in each human organization.

Understanding the influence of these variables on the dynamics of the institutional mechanisms set out in a constitution is essential for envisioning the future of constitutionalism in the contemporary world.

Despite its plural recognition, in Häberle's sense (2006), constitutionalism needs to be endowed with at least six concrete elements that make its existence and effectiveness possible to a greater or lesser degree.

According to this author, an effectively constitutional state needs to i) ensure a democracy based on pluralism, i.e. materially made up of fundamental rights and guarantees, such as the right to freedom and the diversity of ideals and their expressions; ii) establish fundamental rights; iii) separate government powers into distinct functions and activities; iv) guarantee a minimally organized administrative activity, with the division of competences and procedural rites for the application of the law; v) promote the "rule of law", and vi) ensure effective legal protection, through the independence of the courts, with the guarantee of a constitutional justice capable of unimpeded interpretation of the constitution and the law (Häberle, 2006).

These conditions are essentially indicative. Therefore, in view of the various historical, cultural and socio-political differences present in the most varied political organizations, Canotilho (2003) considers that there is not just one, but "multiple constitutionalist processes, with their own characteristics and challenges".

However, beyond this historical burden, constitutionalism today has the characteristics of a universally generalized concept which, due to this universalization, can refer to various multiplicities of the genre "Constitutional State".

For this reason, while it is a landmark in the history of civilization, it is also a human project in a constant process of development, driven by new realities and needs.

In this historical and evolutionary context, federalism, as a form of political organization of the state, seeks institutional balance, which, carried out in the origins of the political organization of the United States, necessarily resulted in the control of power through its staggering between powers of state with shared functions to legislate, govern and judge.

This is because the notion of controlling the power of the state established the harmonious separation of roles that each branch of government should exercise, so that it is possible to identify in this model of organization an interwoven system of competences shared between the various spheres of political decision-making.

The American experience, the first federalist in the world, established a bold institutional mechanism that made it possible to simultaneously overcome the shortcomings of the confederative model of organization and implement a system in which political power would also be shared and rationally limited by the provision of competence between the federal and state decision-making spheres.

This formula for organizing power recognizes the concomitant existence of two spheres of political power over the same territory, each protected by different themes and governed by a single text: the Constitution.

In this respect, as a historical product of civilizational advances and setbacks, today the federative system of organization, according to the practical experience of each state where this model has been adopted, faces new challenges that are essential to its maintenance.

This is because if before the great driving force of constitutionalism revolved around the limitation of state power and the separation of powers, conditions of sustainability that were relatively widespread throughout the world as desirable, today the problems are much more complex, which is why, as Miranda (2008, p.35) points out:

As the state reaches its maximum expansion, the international community is structured through groupings of states with specific functions that acquire autonomy relative to them (...). The international protection of human rights was born as a result of the trend towards humanization and, above all, the repudiation of the pressure exerted by political regimes of various ideological stripes and the universal awareness of human dignity that was being consolidated. It is true that at the beginning of the 21st century, the political- constitutional landscape is once again one of great transformation and instability. Almost all the totalitarian or authoritarian regimes have gone into irreversible decline and representative democracy is now said to be prevailing. However, there are many contradictions and uncertainties (...). We have not, therefore, reached the end of history - far from it; we have only reached the end of a certain era or a moment of transition, with all the virtualities that it may contain.

Nowadays, the global context provides geopolitical principles that inform post- bipolar international society¹, in the light of which constitutional interpretation related to national development must be made. These principles are as follows: the trend towards the elimination of the welfare state; the global opening up of trade, the power of transnational companies and the techno-economy, which knows no boundaries or homeland, and, finally, the end of governing constitutions (Góes, 2009).

This intense process experienced by humanity increases the complexity of human organization. This increasingly requires an understanding of how the major constitutional systems provide solutions to equally complex legal problems.

These new challenges imposed on federalism today, especially with regard to understanding and delimiting the content of rights, have allowed for the construction of alternatives to traditional power structures.

It is certain that the construction of such alternatives is a key balancing factor for the control of power and for the maintenance of federalism itself as a mode of organization, given that it is an inescapable consequence for the construction of rights in democracies that there is a mode of government capable of reconciling the multiple conflicting interests of a certain political organization, be they local, national or even supranational interests.

Conceiving solutions to these varied problems requires, first and foremost, an understanding of the trajectory of the historical aspects that structure the foundations of Federalism as a constitutional principle of a comparative state, as well as its origin and development.

3. THE FEDERALIST PHENOMENON, ITS ORIGINS AND TRAJECTORY IN THE AMERICAN EXPERIENCE

As a result of the need for political organization, the federal system has considerably changed the ways in which states are organized.

Originating from a political ideal and inserted on American soil, it is the first modern occurrence of this system of organization, although in history it is possible to observe manifestations of the phenomenon since antiquity, albeit on a confederative basis.

¹ This is after the period in which there were two major world centers of power, the United States of America (USA) and the Union of Soviet Socialist Republics (USSR), which occurred with Perestroika (the end of state economic planning) and Glasnost (the process of political openness), crystallized in the fall of the Berlin Wall. In this new context, the United States remained the world's sole pole of power for many years until, with the economic crisis of 2008, the possibility arose of replacing a world with North American hegemony with a multipolar world or one without the central dominance of the USA, based on the emergence of other superpowers, a situation that still potential in the case of Russia and India (Carvalho, 2020).

Promoted by intellectuals and politicians such as Hamilton, Madison and Jay (2003), who wrote and strongly defended in the most varied circles of American society the conceptions of a united and strong nation, with a central government capable of providing effective defense and a potential trade that would attract the attention of the world, federalism was strongly opposed by an opposing current: the antifederalists.

For the antifederalists, it was necessary to maintain a less complex model of organization, capable of preserving the resolution of matters within the reach of its citizens, and overvaluing the communal nature of the smallest administrative units would be the most appropriate solution.

Although discussions about the best model to follow went on for many years, much of it through public conventions and informational pamphlets - publications such as the Daily Advertiser set out the point of view that would later be defended in the Philadelphia Assembly, defining the federalist framework as the final destination.

In the words of Ramos (2011, p.32), "(...) federalism emerged victorious from the struggle, shaping the United States of America in the almost prophetic predictions of the three authors cited regarding its development and the possibility of becoming the greatest nation on earth".

One of the essential aspects of the federative theory, used as a driving idea to convince the colonies to give up their sovereignty (both internal and external), was the exchange of this for a kind of autonomy, added to the military and economic gains that a federative model would bring.

Once the conversion of sovereignty into autonomy is accepted in the rule governing the federal state, it would be up to the Constitution to establish the scope of action of each entity, embodied in an interwoven system of distribution of competences.

However, when analyzing the technical elements of federalism, it is possible to conclude that this system goes much further than a simple division of activities and territory. In this respect, democracy is an important element that needs to be given prominence.

Under this analysis, Ramos (2011, p.47) explains it well, stating that:

(...) the preferred mistress of a legitimate federal state, that is to say, one that meets the minimum requirements for a balanced distribution of power, is democracy, because it encourages the conscious participation of citizens in public affairs, allowing direct communication between political entities to be permanently strengthened. After all, it was the need for the decisions of the central power to have a direct impact on the citizens of the member states that made it possible to revise the confederative system and build the federative system (...).

In addition to these characteristics, Ramos (2011) applies the so-called "quality test". In this system, the author brings together the essential elements of the most up-to-date notion of federalism.

For him, a unique condition for federalism is the presence of i) a written and rigid constitution that delimits the distribution of powers and establishes criteria for the distribution of competences, ii) the recognition of more than one sphere of political power, given that the federative model is a form of composite state, iii) the autonomous spheres referred to in the previous item having powers and competences that can distinguish them as a single entity, endowed with its own legal personality, iv) the indissolubility of the federative bond, and v) the existence of a Constitutional Court as guardian of competences and the constitution (Ramos, 2011).

One of the essential elements of federalism, applied to the American experience, is the union of numerous autonomous political entities around common goals. This basic characteristic is the subjective precursor to the establishment of the federal mode of organization. This means that, at a certain political and historical point in the development of federalism, there must be a condition or circumstance of an economic, military, geopolitical or social nature that requires sovereign entities to unite their interests.

It is clear from the historical study of the United States that the union arises more from practical needs than from mere interests. This is because the interests - to a large extent - are satisfied, which would lead one to conclude that once the common interest has been achieved, the continuity of the federal community would be pointless.

This detail allows us to infer that the union of autonomous states is based on the human imperative that unity is strength. This conclusion, although simplistic, clearly shows why entities give up part of their autonomy.

The existence of a military threat or the need to establish economic power in a given region distinguishes this political organization, although it cannot explain it in its entirety.

Driven by needs and lasting interests, in the federal state the member states need to unite rationally in order to avoid certain harmful consequences, namely: i) the collapse of a large part of the decision-making processes and capacities already in place by the ruling political estates; ii) the rickety productive and entrepreneurial relations of the bourgeois class. In addition, the federal state must necessarily achieve i) the establishment of healthy commercial relations between the member states, to be regulated by common public norms that are capable of inhibiting unfair competition and the abuse of economic power; ii) security in internal and external relations, through the establishment of military forces and iii) legal predictability in relations between private individuals and the state.

These needs, whether met or not, will reveal the (in)efficiency of the federal organization. Given its complexity, the entities create institutions and rules for the administrative performance of the political structure.

These rules and institutions are laid down in the written political contract called the constitution.

4. THE NEW FINTECH FEDERALISM

The financial services industry has transformed rapidly over the last twenty years. From lending to payment processing, the core functions of banks are increasingly performed by financial technology companies (fintechs)².

Fintechs use digital platforms and innovative data processing techniques, including automation and artificial intelligence, to offer customers cheaper services and convenient financial products.

At the beginning of the COVID-19 pandemic, requests for financial aid due to the numerous lockdowns further reinforced the importance of fintechs for the US financial system, as many consumers migrated to digital providers.

Without the overhead of physical stores, fintechs are remarkably lean, which allows them to lower the price of offering their services. In fact, many fintechs are little more than startups (Reis, 2020).

In contrast to the generalist stance of traditional banks as one-stop shops for a variety of businesses, fintechs usually specialize in a single type of financial service.

(...) disaggregation, because - the unified process of accepting deposits, granting credit and processing payments has fragmented into several companies; and disintermediation, because these specialized companies have replaced traditional financial intermediaries, such as banks.

US legislation has struggled to accommodate the unbundling and disintermediating nature of fintech. Currently, the US operates under a division of regulatory authority between state and federal governments, designed to govern a financial landscape composed exclusively of large traditional banks.

To reach the market, state and federal authorities have undertaken a diverse series of regulatory initiatives. However, the resulting legal frameworks have varied widely, producing a mishmash of policies with contradictory means and incoherent ends.

Economists characterize the inconsistencies between state and federal responses to fintech as a crisis for the federalist structure of US financial regulation (Seymour, 2022).

Numerous officials have relied on the prevailing regulatory paradigm of the last century, seeking to extend its already extended logic into the realm of fintech and exacerbating its many shortcomings in the process.

These traditional approaches insist that states should control fintech activities within their geopolitical dividing lines, using the long-standing tools of compulsory licensing, securities issuance and consumer protection (Seymour, 2022).

But for fintechs, which use foreign providers, consumers have access to their systems exclusively

through the virtual world and the costs of complying with state laws creates conflicting, costly and in some cases prohibitive problems.

At the federal level, proponents of the prevailing paradigm adopted entity-based regulation. In addition, they expanded preemption to federally licensed companies, repeating it in state laws.

For financial technology companies, federal preemption has served as a vehicle for regulatory arbitrage, encouraging rent-a-bank schemes, which jeopardize the survival of this new business system (Seymour, 2022).

The federal entity-based view also permeates the binary approach to systemic risk controls, which fixates on large systemically important financial institutions while ignoring the growing macroprudential threat posed by a fragmented fintech sector.

However, several regulatory initiatives in recent years have broken with previous thinking and charted a different path, one that redefines the relative domains of state and federal governments and promises a legal regime suited to the technological realities of 13th century finance.

This emerging paradigm is known as the new federalism, constituting a radical reversal of the previous division of authority between state and federal actors. Through cooperative and unilateral initiatives, states are increasingly adopting an approach based on interstate reciprocity that retains the benefits of jurisdictional competition and reduces the courses of redundant financial operations.

The new fintech federalism is a solid governmental response to a question of direct economic logic. As fintechs offer online services, their business model is inherently interjurisdictional.

Thus, subjecting fintechs to the divergent legal regimes of each member state in which they operate through high compliance costs, which threaten the economic viability of startups, hinders innovation. Thus, allowing fintechs to opt for the laws of a single state is equally undesirable. When deciding where to incorporate, fintech owners will seek to maximize the value of their company by choosing the most beneficial regime for their investors, who are usually sophisticated venture capital fund managers.

However, these agents do not have an incentive from the US government to fully internalize the costs of their choice of jurisdiction on remote third parties or consumers unable to protect themselves through contract (Seymour, 2022).

To cater to investors, the states competing in the fintech game will adopt under protection rules, as they receive the full benefit of the fees for operating their services, but suffer only a fraction of the tax costs in relation to the national population.

The optimal regulatory regime therefore federalizes legal issues in areas that generate significant externalities, such as consumer protection and prudential requirements,

² Christopher Bradley defines fintech as “any tool or application that in any significant part relies on advanced technology to play a significant role in financial transactions”.

while promoting state competition in areas such as fintech governance, which are unlikely to produce substantial spillovers (Seymour, 2022).

The new fintech federalism follows exactly this path by reversing the prevailing classical division of territorial competence known as federalism.

5. FINAL CONSIDERATIONS

The Federal State, as a model of management and division of tasks, has the United States of America as its greatest exponent and presents both positive points and challenges when it comes to its practical implementation, respecting its historical and political characteristics.

Even so, it is understood that the benefits are greater than the controversial points, above all because of the possibility of limiting power by power (checks and balances), which prevents tyranny and the concentration of decisions in the hands of a single agent or state entity.

New challenges require new solutions. As the rise of fintech has transformed the US financial sector, the courses of the current legal landscape for entrepreneurs, consumers and the economy as a whole have become quite clear.

However, through various policy initiatives, state and federal authorities have pioneered a new division of authority between these two levels of government, compatible with the inter-jurisdictional nature of fintech.

This new fintech federalism promotes interstate competition for governance rules, while federalization is a process that produces inefficiency, increased costs and collective action problems.

This article has theorized the conceptual possibility of a federalism of financial technology companies, which fulfill their business functions, representing something new in the face of the classic federal model of local and federal regulatory bodies.

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