

COMPETITION AMONG INSTITUTIONS

Competition among Institutions

Edited by

Lüder Gerken

*Director of the Walter Eucken Institut
Freiburg, Germany*





First published in Great Britain 1995 by
MACMILLAN PRESS LTD
 Houndmills, Basingstoke, Hampshire RG21 6XS
 and London
 Companies and representatives
 throughout the world

A catalogue record for this book is available
 from the British Library.

ISBN 978-1-349-24264-1 ISBN 978-1-349-24262-7 (eBook)
 DOI 10.1007/978-1-349-24262-7



First published in the United States of America 1995 by
MACMILLAN PRESS LTD
 Scholarly and Reference Division,
 175 Fifth Avenue,
 New York, N.Y. 10010

ISBN 978-0-312-12581-3

Library of Congress Cataloging-in-Publication Data
 Competition among institutions / edited by Lüder Gerken.
 p. cm.

Includes bibliographical references and index.

ISBN 978-0-312-12581-3

1. Competition—Congresses. 2. Competition, International—
 —Congresses. 3. Organizational change—Congresses. I. Gerken,
 Lüder.

HB238.C64 1995
 338.6'048—dc20

94-42269
 CIP

© Lüder Gerken 1995

Softcover reprint of the hardcover 3rd edition 1995 978-0-333-64204-7

All rights reserved. No reproduction, copy or transmission of
 this publication may be made without written permission.

No paragraph of this publication may be reproduced, copied or
 transmitted save with written permission or in accordance with
 the provisions of the Copyright, Designs and Patents Act 1988,
 or under the terms of any licence permitting limited copying
 issued by the Copyright Licensing Agency, 90 Tottenham Court
 Road, London W1P 9HE.

Any person who does any unauthorised act in relation to this
 publication may be liable to criminal prosecution and civil
 claims for damages.

10 9 8 7 6 5 4 3 2 1
 04 03 02 01 00 99 98 97 96 95

Contents

<i>Acknowledgements</i>	vii
<i>Notes on the Contributors</i>	viii
<i>Introduction</i>	x
1 Institutional Competition: An Orientative Framework <i>Lüder Gerken</i>	1
PART I BASIC ISSUES OF INSTITUTIONAL COMPETITION	
2 Competition among Institutions: Evolution within Constraints <i>Wolfgang Kerber and Viktor Vanberg</i>	35
3 Causes of Changes in Political-Economic Regimes <i>Peter Bernholz</i>	65
4 Legal Experiences of Competition among Institutions <i>Christoph Engel</i>	89
5 International Migration and Institutional Competition: An Application of Hayek's Evolutionary Theory <i>Patrick Welter</i>	119
6 Competition among Legal Institutions: Implications for the Evolution of Law <i>Bruce L. Benson</i>	153
7 Competitions of Socio-Economic Institutions: In Search of the Winners <i>Pavel Pelikan</i>	177
PART II SPECIFIC ASPECTS OF INSTITUTIONAL COMPETITION	
8 Competition among Jurisdictions: The Idea of FOCJ <i>Bruno S. Frey and Reiner Eichenberger</i>	209
9 The European Market for Protectionism: New Competitors and New Products <i>Andreas Freytag</i>	231

10	Liberty, Competition, and the Rise of Coercion in American Federalism <i>John Kincaid</i>	259
11	Standardization: The Evolution of Institutions versus Government Intervention <i>Günter Knieps</i>	283
12	Transformation of the Economic System in the Russian Federation: What Role for Competition among Regional Governments? <i>Matthias Lücke</i>	297
	<i>Author Index</i>	319
	<i>Subject Index</i>	323

Acknowledgements

Early versions of the papers in this volume were presented at the international 1994 Friedrich August Hayek Symposium at Bleibach in the Black Forest, Germany. The conference was cosponsored by the Walter Eucken Institut at Freiburg, Germany, and the International Institute of George Mason University at Arlington, Virginia, USA. Funding by Daimler-Benz-Fonds, George Mason University Foundation, Rudolf Haufe Verlag and The Sarah Scaife Foundation is gratefully acknowledged.

In addition to the authors represented in this volume, the following delegates were also present at the Symposium: Peter Aranson, Louis DeAlessi, Douglas Ginsburg, Carola Lehmer, Henry Manne, Vitali Naishul, Steve Pejovich, Karl-Ernst Schenk, Dieter Schmidtchen, Kazimierz Stanczak, Manfred Streit, Gordon Tullock, Roland Vaubel, Stefan Voigt, Christian Watrin and Ulrich Witt.

The editor would like to thank, above all, John Moore of the International Institute for the co-operation in jointly organizing the conference. Advice and assistance by Wolfgang Kerber and Viktor Vanberg are also gratefully acknowledged. Daniela Gerbaldo of the Walter Eucken Institut coordinated the details of the conference. Wendula Gräfin von Klinckowstroem and Reinhard Cluse of the Walter Eucken Institut assisted in producing this volume.

*Walter Eucken Institut
Freiburg im Breisgau*

LÜDER GERKEN

Notes on the Contributors

Bruce L. Benson, Distinguished Research Professor at Florida State University, has written widely on spatial economics, public choice, and the economics of law, including books on *The Enterprise of Law* and *The Economic Anatomy of a Drug War* (with David W. Rasmussen).

Peter Bernholz is Professor of Economics and a director at the Basel Centre for Economics and Business, University of Basel.

Reiner Eichenberger is research associate at the University of Zürich. He is mainly interested in political economy, in the economics of information and in psychological economics.

Christoph Engel is Professor of Law at the University of Osnabrück, Germany. His main fields are economic law, media and communication law, European Union law, German public law.

Bruno S. Frey is Professor of Economics at the University of Zürich. He was Visiting Research Professor in the School of Business, Chicago University. His current main research areas are political economy, psychological economics and the economics of the arts.

Andreas Freytag is secretary and research associate at the Institute for Economic Policy, Cologne. His main fields of research are theoretical and empirical analysis of international economics and political economy.

Lüder Gerken is a Director of the Walter Eucken Institut at Freiburg, Germany. His main fields of research are the analysis of institutional competition, institutional economics and economic issues of the European Union.

Wolfgang Kerber is a Director of the Walter Eucken Institut at Freiburg, Germany. He has published on competition theory, antitrust policy, institutional economics and evolutionary economics.

John Kincaid is Robert B. and Helen S. Meyner Professor of Government and Public Service and director of the Meyner Center for the Study of State and Local Government at Lafayette College, Easton, Pennsylvania; former Executive Director of the US Advisory Commission on Intergovernmental Relations, Washington, DC; and Editor of *Publius: The Journal of Federalism*.

Günter Knieps is Professor of Economics and Director of the Institute of Transportation Economics and Regional Policy at the Albert-Ludwigs-Universität Freiburg i.Br.. His special fields are competition policy, industrial economics and the theory of regulation.

Matthias Lücke is a research associate in the Development Economics Department at the Kiel Institute of World Economics. His research has focussed on trade and industrialisation issues and more recently, on patterns of regional integration (and dis-integration) in the former Soviet Union.

Pavel Pelikan, a doctor in economics, is senior research fellow at the Industrial Institute for Economic and Social Research in Stockholm, Sweden, and regular visiting professor at the Université de Paris 1–Sorbonne. He has published on evolutionary comparative economics and post-socialist transformation.

Viktor Vanberg is Editorial Director at the Center for the Study of Public Choice and Professor of Economics, George Mason University, Fairfax, Virginia. He has published on the theory of social institutions and organizations and is editor of the *Journal of Constitutional Political Economy*.

Patrick Welter received a diploma degree in economics in 1990. Since that time he has been working as a research assistant at the Seminar for Economic Policy, University of Cologne. He is currently preparing a PhD thesis on the problems of establishing an international migration order.

Introduction

It is generally accepted by economists that competition is an essential prerequisite for the increase of welfare in that it induces individuals to develop, for a specific problem, different solutions among which, in the course of time, inadequate solutions will be substituted by more efficient ones. Simultaneously, competition prevents the stabilization of accumulated power and thus enhances the preservation of individual freedom. However, these aspects of competition have been discussed mainly with reference to economic markets in which firms and households compete within a given set of institutions, that is within a legal order. The question arises as to whether competition may also evoke comparable effects on the institutional level, in the sense of competition among legal orders.

Economic science has only recently become more deeply involved in the analysis of institutional competition. One reason for this new interest may be the perception that the highly developed economies in Europe and North America are presently confronting considerable problems: The density of regulations, constraining particularly economic activity, has increased rapidly, despite the proclamations of politicians that they are aiming to promote deregulation. The public share of the gross national product has increased considerably, due to social benefits programmes, active employment policies and subsidization of industries. Regulatory competence has shifted from regional jurisdictions to the federal level, leading to a concentration of power. Government is perceived as acting inefficiently. The growing influence of competing interest groups prevents politicians and bureaucrats from adequately solving present-day problems. Institutional competition is increasingly suggested as a possible solution for such problems.

The term institutional competition is ambiguous in its meaning. On the one hand, in a more intuitive way, institution stands for organizations, particularly jurisdictions like a state. Yet institutions can also be defined as rules that constrain actions of individuals. Accordingly, institutional competition may be associated with both competition among jurisdictions, particularly states, and competition with or among rules. In many cases these meanings will coincide. However, this need not be the case. Jurisdictions may compete also on other grounds than with their legal systems, and competition among rules, in a wide sense, may also encompass the interactions between designed and spontaneously evolved rule systems.

The present book is an attempt to address some of the aspects associated with institutional competition and to identify some possible lines for further research. It is far from offering a coherent *theory* of institutional competition. The book is organized into two parts, which are preceded by a general orientation. The aim of the orientative paper, in Chapter 1, is to sketch the vast and complex spectrum of institutional competition with special reference to competition among states, and to construct a general framework that may help to identify the positions of the following papers within the overall context.

Part I examines basic issues of institutional competition. In Chapter 2, Wolfgang Kerber and Viktor Vanberg focus on two issues of competition among jurisdictions by using an evolutionary approach. First, they show that institutional competition can be profitably viewed as a knowledge-creating process that brings forth new and better rules. Second, they argue that, just as competition in ordinary markets has to be constrained by certain rules in order to ensure desirable outcomes, competition among jurisdictions also needs a framework of rules that constrains the strategies of the competitors (jurisdictions) and channels the competitive process into desirable directions.

Peter Bernholz, in Chapter 3, discusses from a long-term evolutionary perspective the factors that bring about changes in economic and political systems. He argues that democratic market economies regularly degenerate into excessive welfare states, thus leading to a crisis, that may give rise to ideological movements as well as the implementation of central planning and of a dictatorship. However, as Bernholz stresses, competition among states will eventually induce economic reforms towards a market economy, which sooner or later will also require a democratic regime and the implementation of the rule of law. Bernholz concludes that evolutionary cycles among political and economic systems have to be expected.

The paper by Christoph Engel, in Chapter 4, classifies and investigates the legal material with respect to institutional competition. Engel explores in what ways specific segments of the overall law system of a state may be exposed to competition. He concludes that institutional competition is much more frequent and manifold than economic analysis often perceives. He also explores the attitude of the legal orders toward institutional competition and finds that it is very pragmatic: While its positive effects are often applauded, the law in other instances is more reserved or even reluctant to competition. Engel finally analyzes the range of instruments that law has developed in order to reduce frequency or impact of unwelcome institutional competition.

Patrick Welter, in Chapter 5, provides a challenge to the argument that unregulated international migration is inherently inefficient (because migrants do not take into account fiscal externalities that they impose on the residents of the immigration country as well as of the emigration country) and that therefore an international agreement on migration policies is desirable in order to internalize these externalities. Welter argues that such an agreement may neglect the relevance of migration in promoting institutional competition. He models institutional competition on the basis of Hayek's evolutionary theory and analyzes from this perspective the set of migration policies: subsidies to migrants, migration taxes and transfers between states. Welter concludes that neither migration taxes nor transfers between states are adequate, while subsidies to migrants and, under certain conditions, immigration taxes are compatible with institutional competition.

Bruce Benson, in Chapter 6, explores the relationship between spontaneously evolved rules and designed rules. He argues that an individual can expand wealth through productive activities, particularly when these are complemented by voluntary interaction with others, and that spontaneously evolved legal institutions can facilitate both productivity and voluntary interaction. However, as Benson emphasizes, an individual can also expand wealth by taking from others, and the design of legal institutions can generate and enforce such a redistribution. He concludes that an analysis of the evolution of legal institutions must account for competition and interaction between those rules which evolve spontaneously to facilitate voluntary interaction, and those deliberately designed rules which alter spontaneous rules in order to take property.

The paper by Pavel Pelikan, in Chapter 7, draws a broad picture of social evolution by identifying and interrelating different types of institutions and competitive processes. Pelikan argues that institutional rules are the selection units of social evolution. He distinguishes between the analysis of given institutions (institutional statics), and the examination of how institutions themselves change and evolve (institutional dynamics). As for institutional statics, Pelikan assumes that in the competitive process some institutions win and others lose, and inquires into properties of potential winners. With regard to institutional dynamics, Pelikan provides a framework for understanding why, in the evolutionary process, democracy is superior to dictatorship and cultural reformism is superior to conservatism. He also argues that the deliberate design of rules is an important means for distinguishing and rectifying those institutions which eventually would be eliminated by social evolution, and that theoretical knowledge produced by the study of social evolution will play an increasingly important role in this respect.

Part II of this volume addresses specific aspects of institutional competition. In Chapter 8, Bruno Frey and Reiner Eichenberger derive a concept of functional, overlapping, competing jurisdictions (FOCJ) on the grounds of the economic theory of federalism. They argue that FOCJ have major advantages, in that governments of FOCJ face strong incentives to satisfy citizens' demands and that, as FOCJ are highly flexible, they adapt to the 'geography of problems'. Frey and Eichenberger stress that successful FOCJ have existed in European history, and that there are illustrative contemporary examples for FOCJ such as the US special districts and Swiss communes. They conclude that a future European constitution should actively support the evolution of FOCJ, thus complementing the policy of the European Union which so far excelled in strengthening economic competition, but neglected to promote competition among jurisdictions.

The paper by Andreas Freytag, in Chapter 9, provides in a public choice framework a model of competition among the European Commission and the national governments on the market for protectionism. According to Freytag, the European Commission as a new competitor is a serious threat to national suppliers of protectionism. He analyzes the competitive process, that he views as a Schumpeterian process of creative destruction with the European Commission being the innovator in that it supplies strategic trade and industrial policies as new products, while the national suppliers are imitators that try to survive on the market. Freytag discusses the set of possible strategies of the competitors and validates the theoretical findings by analyzing the Common Technology Policy and the subsidization of the European aircraft industry.

John Kincaid, in Chapter 10, argues that American federalism has entered a new era of coercion in which the federal government is engaged in unprecedented regulation of state and local governments and displacement of their sovereign powers. He inquires into the reasons for this development, which has given rise to what he calls 'coercive federalism'. Kincaid argues that institutional competition among subnational jurisdictions came to be seen as limiting the ability of governments to respond to social problems and especially to act against the powers of big business. He also finds that demands for more equality on a national scale, especially in protecting individual rights, generated political pressures against decentralized state regulations. According to Kincaid, federal policy-making has therefore shifted its attention from concerns about states' rights to concerns about individual citizens' rights. Kincaid concludes that, in order to provide economic benefits to persons and protect individual rights, the federal government is pre-empting state and local powers and has few incentives to co-operate with state and local governments.

Günter Knieps, in Chapter 11, focuses on institutional competition among standardization committees. He argues that hierarchical control of standard setting within large technical systems, like telecommunications and railway networks, no longer remains sustainable due to the recent trend towards vertical disintegration, deregulation and internationalization, and that therefore committees and regulatory commissions play an increasing role in the process of setting compatibility standards. Knieps undertakes two case studies, on telecommunications and railway systems, in order to point out the importance of variety and search for new solutions that is generated by competition among standards. Moreover, Knieps explores whether common rules with respect to standard-setting should be designed and enforced by regulatory authorities.

The final paper by Matthias Lücke, in Chapter 12, analyzes the potential contribution of competition among regional units to the economic transformation of the Russian Federation. Lücke finds that several presumed benefits of interregional competition are likely to apply also to the case of Russia. These include regional differentiation in the provision of public goods, enhanced public control over bureaucrats, and the discovery of knowledge that would not be disclosed in the case of centralized decision-making. However, as Lücke argues, interregional competition will only be effective if the national constitution guarantees basic rights, including the free movement of people, goods and money throughout the country. Furthermore, he makes an economic case for requiring all regions to share in the financial obligations that result from Russia's communist past, such as an oversized army and the dangers of ecological disaster.