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Democratic Governance for a Globalized World*

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Globalization creates a new dynamic geography of political problems, which is incompatible with the rigid boundaries of established democratic structures. We discuss this conflict within a behavioral framework which incorporates individuals' civic virtue and suggest ways to overcome it. We advance three new types of flexible democratic governance. The first proposal extends the concept of citizenship to institutions beyond states in order to provide a sense of belonging and to therewith bolster civic virtue. The second and third proposals allow for jurisdictions to adjust to the geography of problems as well as the international exchange of politicians.

Die Globalisierung der Wirtschaft schafft eine neue dynamische Geographie der politischen Probleme, die mit den heutigen starren demokratischen Institutionen unvereinbar ist. Wir analysieren die sich daraus ergebenden Konflikte im Rahmen eines um den Bürgersinn vieler Menschen erweiterten Verhaltensmodells und präsentieren drei Lösungsvorschläge. Der erste Vorschlag zielt auf die Flexibilität der Bürger und erweitert das Konzept der Bürgerschaft auf nicht staatliche Institutionen. Damit wird das Zugehörigkeitsgefühl der Individuen und so ihr Bürgersinn gestärkt. Der zweite und dritte Vorschlag stärkt die Flexibilität der politischen Institutionen. Funktionale staatliche Einheiten (FOCJ) können ihre Tätigkeit viel leichter als multifunktionale Gebietskörperschaften der „Geographie der Probleme“ anpassen, und Politiker und Parteien sollen ihre Dienste grenzüberschreitend anbieten können.

La globalisation de l'économie crée une nouvelle dynamique des problèmes politiques à laquelle ne répond plus nos institutions démocratiques actuelles compte tenu de leur rigidité. Nous discutons ce conflit dans le cadre d'un modèle de comportement qui incorpore la vertu civique des individus et nous proposons trois types de solution. La première élargit le concept de citoyenneté aux institutions non-étatiques. Le sentiment d'appartenance des individus et l'engagement civique se voient ainsi renforcés. Les deuxième et troisième propositions visent la flexibilité des institutions politiques. Les unités fonctionnelles (FOCJ) peuvent mieux ajuster leurs activités à la nouvelle géographie des problèmes que les collectivités territoriales. A cet égard, les politiciens et les partis doivent pouvoir offrir leurs services au niveau international.

Democratic Governance for a Globalized World

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I. CONFLICTS BETWEEN GLOBALIZATION AND DEMOCRACY

Globalization is a fact of life. It cannot reasonably be disputed that the economy and society have become more international over the last few decades. More and more economic and political decisions are strongly shaped by global influences. At the same time, the global sphere is far more dynamic than the national states (see, e.g., Rodrik 1998).

Globalization is driven by *technical* progress. The reduction in the cost of information, communication, computation and transportation makes the world more interdependent, which promotes two major political developments:

(a) “Technical cooperation” among governments is on the increase in a large number of areas. This is most visible at the international level, but local and regional political interlinking is also enhanced. The most prominent examples are:

- International cooperation via international organizations (e.g. in the economic and financial areas the World Trade Organization, the World Bank, and the International Monetary Fund; in social affairs UNICEF, UNESCO; or in defense NATO), and via international treaties (e.g. the Kyoto Protocol for the global environment, or the Bologna Convention for higher education in Europe);

- regional organizations, such as the European Economic Area or the European Union; and,
- at the local level, “special areas” (or, as they are aptly called in German, “*Zweckverbände*”), which are designed to come to grips with the many problems transgressing existing jurisdictional boundaries.

(b) The responsibility for dealing with (supposedly) difficult “technical” problems beyond the competence of individual governments are increasingly being shifted to independent bodies. Obvious examples are central banks, courts, and a multitude of “advisory” bodies, such as educational, financial or technological councils.

Both developments result in decision processes far removed from the citizens. While they respond to the problems as seen from a technocratic perspective, they are dominated by bureaucratic considerations as well as the interests of the “*classe politique*”. Globalization therefore provokes some major conflicts with democracy by creating a new geography of dynamic problems, which is incompatible with the rigid boundaries of established democratic structures.

This paper discusses the consequences of this conflict and suggests ways to overcome them. Section II identifies two popular reactions to the conflict between globalization and democracy. The first idealistically wants to establish a world government, and the second relies on global markets as the solution to all problems. But both ideas have major drawbacks. The first assumes that all politicians are benevolent, the second presumes that all actors behave purely egoistically and that competition is perfect. We contend that neither of these assumptions are valid. Section III discusses the political effects of globalization within a broader and more open behavioral framework which acknowledges that individuals are motivated by extrinsic as well as intrinsic influences, most importantly civic virtue, and there is a systematic interaction between extrinsic and intrinsic motivation. In such a framework, a major consequence of globalization is a deep-seated tension between established politicians (or the “*classe politique*”) and ordinary citizens. One manifestation is a fundamentalistic opposition against economic globalization. Another manifestation is that civic virtue on the part of both citizens and politicians tends to be crowded out.

Therefore, the conflict between dynamic globalization and democracy can only be solved by making democratic governance and the political sphere more flexible. However, proposals to increase political flexibility have to take into account the behavioral aspects.

Section IV advances three proposals for flexible democratic governance going beyond the idealist notion of a benevolent world government, or leaving everything up to the markets. The first looks at the *demand* for institutional flexibility by individuals. The concept of citizenship is extended to institutions beyond states in order to provide a sense of belonging and to therewith bolster civic virtue. The second and third proposals look at the *supply* side of institutions and allow for jurisdictions to adjust to the geography of problems as well as the international exchange of politicians. While the relationship between the three proposals is discussed in section V, section VI investigates some of the most important reservations there are against our proposal. The final section VI offers concluding remarks.

II. UNDERMINING DEMOCRACY

The fundamental conflict between globalization and democracy has been observed in many quarters (e.g. von Weizsäcker 1999, Beck 2000, Bernholz 2000). It has resulted in two quite different, and in many respects even opposite conceptions:

(a) “Idealists” resurrect the perennial dream of a *world government* committed to the rule of law, human rights and democratic procedures. Many see the United Nations as the preliminary form of such a world government and are prepared to take its well-known limitations as a transitory phase that will be overcome with time.

(b) “Market believers” rely on the *global market* to essentially solve all problems, provided governments do not interfere. They generally admit the necessity of having some rules to the game (such as a guarantee of property rights) but they believe that such rules emerge endogenously as a result of international competition.

We take both conceptions to be seriously lacking. The notion of a world government tries to superimpose a power structure on existing national government, without considering where the power should originate from. While it assumes policy failure because of the self-interested behavior of nations, it naively presumes that a world government would act out of global interest. However, even a representative democratic world government could not provide true democratic governance, but would exhibit pervasive government failure due to its large distance from the citizens and its monopoly power. At best, such a “world” government is the apex of the dominant world power (today the United States), which certainly does not meet the ideal of an institution fairly and equitably serving the interests of mankind.

The notion of a globalized world market setting its own efficient rules is equally naive. It disregards the classical problems of market failures leading to monopolistic structures, wide ranging negative external effects (particularly with respect to the natural environment) and insufficient supply of public goods, as well as an income distribution between regions and individuals which is not acceptable from most points of view. However, it is also unwarranted to expect that globalized economic markets induce governments to provide public goods effectively. There is no reason why competition among national governments should work perfectly as long as the cost of migrating for the average citizen remains high (Epple and Zelenitz 1981).

Indeed, we presently observe heated and even violent protests against both kinds of conceptions. In particular, the United Nation's financial institutions of the World Bank and IMF, the World Trade Organization (WTO), as well as groups of national governments (e.g., the G8) have recently met with stiff opposition when they held their meetings. They have partly been forced to step back from what has been interpreted to be a support of "global capitalism". They formally had to acknowledge the concerns formulated by vociferous interest groups and NGOs supported by worldwide media attention and chaotic protests, which either reject globalization or demand that they get a formal say in global politics. However, such lobbying activities of self defined groups and organizations are a far cry from any democratic representation, and they take place outside generally accepted (constitutional) rules. Therefore, they do not provide a model for solving the conflict between globalization and democracy.

III. TENSIONS BETWEEN POLITICIANS AND CITIZENS

Fearing the consequences of globalization for the effectiveness of politics, citizens have not only become most reluctant to grant governments the right to undertake international and intranational cooperation, but they have also lost trust in politics in general (see Blendon et al. 1997). They rightly feel that they have lost control over the decisions taken in the respective supra-national and inter-jurisdictional bodies. In contrast, professional politicians, as well as public officials, aim at shifting decisions upwards to the international and co-operational arena for exactly the opposite reason, namely that at this higher level, they are better able to pursue their own goals and what they believe to be in the interest of their countries, without always having to seek the citizens' approval.

Because of the citizens' reluctance to go along with centralizing formal decision making at global, international and inter-jurisdictional levels, there is less *formal* cooperation at those levels than the population would like when unbiased democratic decision procedures are available. Decision-making in the European Union, whose (implicit) constitution is far from being democratic, provides an example. Formal decision-making in the European Union will only find wide approval if the citizens are convinced that the procedures are based on democratic principles, in particular that the politicians can be made accountable for their decisions. In contrast, politicians as well as public officials, prefer less visible *informal* "technical" cooperation, on which the citizens have little, if any influence. An example are the meetings of heads of state in the European setting, where sometimes far reaching decisions are channeled. Even less democratic are the "informal" decisions reached by ministers or state secretaries, a pertinent example being the Bologna Convention, which has major implications for the organization of university education in Europe.

The increased importance of "technical" decisions induced by globalization has another, even more important negative consequence: Civic virtue, which mirrors the intrinsic motivation of the citizens and the politicians to contribute to public interest, is endangered. But it has by now been well established that civic virtue with both citizens and politicians is an indispensable factor for a successful democracy (see, e.g., Brennan and Hamlin 2000, or Putnam 1993, 2000). Of course, this behavioral insight not only goes beyond traditional welfare economics which assumes that citizens are totally egoistic and politicians permanently benevolent. It also goes ahead of the traditional theory of Public Choice which assumes that citizens and politicians behave purely egoistically.

The traditional rational choice approach, which has successfully been applied to many social problems (see Becker 1976, Kirchgässner 1991, Lazear 2000), is ill-equipped to deal with governance issues in which intrinsic motivation plays an important role. Sure enough, the traditional homo oeconomicus model does not deny that people's behavior may be influenced by intrinsic motives such as civic virtue. But it dismisses intrinsic motivations as either unimportant and fickle or robust but invariable. Thus, traditional rational choice theory overlooks the systematic relationship between intrinsic and extrinsic motivation mentioned above.

A more advanced model of human behavior, which may be called "homo oeconomicus maturus" (Frey 1999), combines the two basically different types of motivation and

explicitly accepts that they are interactive. From this perspective, the crucial question is which factors determine the extent of civic virtue.

Citizens' civic virtue depends on their involvement in politics. Civic virtue is bolstered by having extensive participation rights in political decisions. Frey and Stutzer (2001) empirically show that individuals derive substantial procedural utility from having political participation rights. When citizens experience that they are not involved in decisions they reckon to be important, they become frustrated. This negatively affects the extent of their civic virtue. Well researched examples are the negative effects of weakened democratic rights on tax morale (Pommerehne and Weck-Hannemann 1996) and on individual participation in elections and referenda. Civic virtue is also raised by institutional conditions producing a fair and equitable financial contribution to collective projects, i.e. on the extent of fiscal equivalence. As the citizens have no direct financial responsibility for "technical" decisions, civic virtue tends to be crowded out, which further undermines democracy.

Politicians' civic virtue depends, among other factors, on the obtrusiveness of the popular will. As long as the preferences of the citizens are clearly visible and well informed, many politicians are motivated to follow citizens' interests. But when the citizens' preferences are difficult to identify and do not seem to be well informed, many politicians prefer to cater for the interests of the well-organized and influential interest groups. In other words, many politicians are not pure egoists, but have a preference for being useful to society. However, they also interpret their acts in a self-serving way (see Babcock and Loewenstein 1997). Therefore, a politician's intrinsic motivation to take citizens' preferences into account depends negatively on the ease with which he or she can reinterpret the observed preferences of the citizens.

Another important determinant of politicians' intrinsic motivation is the presence or absence of systematic extrinsic motivators. If politicians are regularly extrinsically rewarded by specific groups, their intrinsic motivation to cater for the welfare of their constituency may be reduced. As a consequence, politicians' civic virtue is bolstered when decisions are taken in a direct-democratic way, because direct-democratic decisions reveal information about the preferences of the citizens, induce the citizens' preferences to be better informed (e.g. compared to preferences elicited by surveys), and result in the direct financial relationships between politicians and interest groups becoming less important. Moreover, direct democracy and the direct election of government politicians favor part-time politicians, who are not necessarily members of

the “classe politique” but are in closer contact with the common citizens and thus more attached to their preferences.

IV. PROPOSALS

The decision-making process dealing with issues of globalization requires more flexible democratic political institutions. They must be able to adjust to the “geography of problems” instead of being bound by traditional boundaries. Thus, globalization has to become symmetric: it has not only to increase the flexibility and effectiveness of economic units, but also of government institutions.

In the following, we advance three proposals to change democratic structures in order to overcome the ossification of the present political system. The first one, flexible citizenship, refers to the demand side of political institutions. The second, flexible political units, and the third, flexible supply of politicians, refer to the supply side of democratic institutions.

A. Flexible Citizenship

1. *The basic concept*

Traditionally, citizenship is a relationship between an individual and a state, in which an individual owes allegiance to that state and is in turn entitled to its protection.

Three aspects of this definition have to be noted:

- The actors involved are the citizens and the *state*. Today, citizenship is a unique and monopolistic relationship between the individuals and a particular *nation*. It is strongly shaped geographically because most of the government services involved are only provided to residents, i.e. citizens living within the boundaries of the respective state.
- The citizens have both *rights* and *obligations*. The rights refer to the *political* sphere (i.e. the citizens have the right to vote and to hold public office), to the *economic* sphere (i.e. the citizens have the right to become economically active as

employees or employers), as well as to the *social* sphere (i.e. the citizens are protected against economic hardship within the welfare state).

- The *relationship* between an individual and the state goes well beyond an exchange of taxes for public services. Rather, the citizen “owes *allegiance*” to the state. The citizens are expected to be public spirited and to exhibit civic virtue. The relationship is thus partly non-functional and resorts to the intrinsic motivation of the citizens¹ and to the community of people who share loyalty and identity (Eriksen and Weigard 2000). This aspect distinguishes the new type of citizenship proposed here from being purely a customer or member of an organization, as theoretically analyzed in the well established Economic Theory of Clubs (Buchanan 1965).

The process of globalization with its decrease in communication and transportation costs undermines the geographically based concept of citizenship for two reasons: first, with increasing mobility of individuals, an increasing number of individuals are living in countries of which they are not citizens. Often, they live in a country only for a short period of time. Then they enjoy part of the rights of citizens, but do not have to carry the respective obligations. Second, the transaction costs for delivering government services to non-residents are decreasing dramatically. An example is education, which can be increasingly supplied via internet to non-residents. Thus, government institutions are becoming more and more virtual (see Colander 2000).

There are two possibilities to evade the rigidity of today's concept of citizenship. On the one hand, the services which do not fit this concept any more can be privatized. But not only does this lead to all the known problems of privatization (income redistribution, regulation of private monopolies, supply of public goods, etc.), but it also makes it impossible to economize on virtue. On the other hand, the existing concept of citizenship can be generalized in various respects, as will be discussed in the following, making it possible to uphold civic virtue and governmental institutions that provide for public goods.

2. *Differentiating citizenship*

¹ These aspects are the subject of a large literature mainly in political science, see e.g. Mansbridge (1994), Fukuyama (1995), Levi (1997) or Putnam (1993, 2000). For contributions in economics, see e.g. Kelman (1987) or Frey (1997). For law, see Cooter (2000). They are also related to social trust, as discussed e.g. in psychology by Kramer and Tyler (1996).

a. *Extending national citizenship*

- *Temporary Citizenship.* An individual should be able to choose for a predetermined period to become a citizen of a particular political unit, for instance because he or she is working and living in a country for a specific period of time.
- *Multiple Citizenship.* For persons simultaneously working and living in various countries, a good solution might be to split up the citizenship into various parts. The rights going with the citizenship must be adjusted accordingly. In particular, the voting rights are to reflect the fact that a person chooses to split up citizenship among several nations. In the computer age, there is no problem whatsoever in allowing for fractional votes.
- *Partial Citizenship.* An individual might be a citizen of a political unit with respect to one particular function, while being a citizen of another political unit with respect to other functions. In referenda, the voting rights should accordingly only extend to issues referring to the respective function.

b. *Citizenship in various types of organizations*

A person may become a citizen of an organization other than the nation. The following possibilities are conceivable:

- *Levels of Government.* Citizenship might refer to the national level – which is the rule – but also to a lower level, such as the region, province or commune (the latter being the case in Switzerland) or to a higher level, such as the European Union.
- *Governmental Sub-Organizations.* Individuals might choose to become a citizen of only part of a government, such as the diplomatic service, the military or the social security administration.
- *Quasi-Governmental Organizations.* There are many organizations close to the public sector in which individuals might become citizens. Universities are such an example. Indeed, the concept of the “*Universitätsbürger*” (university citizen) is well known in the German-speaking academic system. It obviously means much more than being an “employee” of a university. Rather, it means that one is prepared to

commit oneself to the academic life beyond considerations of short term purely personal benefits and costs.

- *Non-Governmental Organizations (NGOs)*. Citizenship may be of organizations such as churches, clubs (e.g. the Rotary Club, the Boy Scouts or even sport clubs such as Manchester United or FC Barcelona); action groups (e.g. the World Wildlife Fund, “Médecins sans Frontières” or the Red Cross), and functional organizations (e.g. ICANN, the “Internet Cooperation for Assigned Names and Numbers”). This dimension of citizenship relates directly to the concept of FOCJ discussed below. Yet another organization in which citizenship may be considered are profit-oriented firms. Citizens of firms have a special relationship, which goes beyond just being a customer or employee or stakeholder. Shareholders have a decision weight according to the number of shares, while stakeholders have no formal voting right at all, but exert pressure outside of established channels, e.g. via the media or demonstrations. In contrast, each citizen of a firm has a vote according to generally accepted democratic principles. While these principles differ, they are not necessarily incompatible with each other. Firm citizenship can exist quite well along with shareholder rights².

Citizenship in the broadest sense proposed here is based on *voluntary contracts* between the persons aspiring towards citizenship in a particular organization and the organization offering the possibility of citizenship. These contracts establish a special bond and are necessarily *incomplete* because it is impossible to state all the contingencies the future might hold.

An *essential* feature of citizenship is that an organization can expect a measure of allegiance and loyalty from its members. Citizens are prepared to abstain from exploiting all short-term advantages. “Citizenship” means that the members exhibit an *intrinsically based motivation* to support “their” organization over and above purely egoistic calculations. This also means that citizens are prepared to co-operate in the provision of public goods, even when pure egoists would try to free ride.

² Two voting principles can co-exist well together. This has been demonstrated by the formal co-determination rights, as they exist in Germany. In that country, in companies with more than 2,000 employees, the shareholders and the representatives of the employees hold the same number of seats in the Aufsichtsrat, the main decision-making body. This arrangement seems to have worked reasonably well.

B. Flexible Political Units

1. The basic concept

The political jurisdictions should extend according to the needs of the various government functions. These needs differ according to the particular function to be provided for. As a result, functional political units generally overlap; a particular geographical area is served by various political suppliers of governmental goods and services. In order to safeguard these units and ensure that they serve the interests of the citizens, they are to be democratically controlled, and the members (ideally small political units such as the communities or even parts of communities) must be able to enter and exit, thus establishing strong interjurisdictional competition. This concept has been called FOCJ, following the initials of its constitutive characteristics: Functional, Overlapping, Competing Jurisdictions³.

2. Free riding contained

Based on the traditional analysis of (local) public goods and external effects, it could be argued that in FOCJ the members will resort to free riding. Thus, for example, communities with many childless inhabitants will give up membership in FOCJ devoted to the supply of school services, and so save the corresponding tax cost. They disregard the interests of the citizens with children, though they enjoy the positive external effects of a good school education. The competition between the jurisdictions is thus predicted to lead to a so-called “race to the bottom”, resulting in under-provision of public goods, and, in the extreme, to a complete breakdown of public supply.

This criticism assumes that individuals exploit any opportunity to free ride. But it is wrong to assume that individuals take full advantage of every opportunity to profit at the expense of others. In the majority of situations, most people do not behave in a purely egoistic way. This applies especially to situations in which moral or altruist behavior only implies low cost, as is the case in the collective democratic decisions at the level of communities (see, extensively, Brennan and Lomasky 1993, Brennan and Hamlin 2000, and for experimental evidence see Eichenberger and Oberholzer-Gee

³ See, more fully, Frey and Eichenberger (1999), and the critical discussion by Vanberg (2000) and Blatter and Ingram (2000).

1998). As an individual only has negligible influence on the communal decision, it has no reason to vote in favor of collective free riding of the community.

Over the last few years, theoretical and empirical research has collected strong and cumulative evidence that shows that, in many situations, individuals are prepared to contribute substantially to what they consider the common good even if the implied cost is much larger than is the case in democratic decisions. Free riding in the presence of public goods (as analyzed by Olson 1965) remains a serious problem, especially when people feel that others do not contribute their fair share, or when the situation is purely anonymous and the possible gain is all too large. But very extensive field studies (see, in particular Ostrom 1990, 2000, Ostrom, Gardner and Walker 1994) confirm that these incentives to free ride need not dictate behavior, especially when the persons know, and communicate with, each other. There is similar evidence from a large number of carefully controlled laboratory experiments. No less than 40 to 60 percent of subjects in a one-shot public good situation contribute to the provision of a pure public good. The level of co-operation remains between 30 and 50 percent of what would be socially optimal, even after many repetitions where the subjects could easily learn to take advantage of each other (e.g. Dawes, McTavish and Shaklee 1977, Ledyard 1995, Bohnet and Frey 1999). Individuals do have a measure of intrinsic values and corresponding *intrinsic motivation* (e.g. Deci 1971), which differs from extrinsic motivation induced by relative price variations.

These insights link up with the rapidly growing research pointing out the importance of social capital for individuals' behavior in the political and general social setting (Coleman 1990, Putnam 2000, Paldam 2000). There is now a wide consensus among social scientists that intrinsic motivation, loyalty, or social capital, is an indispensable resource for a well functioning society⁴. When it is insufficiently developed, or scarcely exists at all, society threatens to break down altogether or at least functions at a low level of efficiency. Thus care must be taken to protect it. It has indeed been shown in experimental (Deci and Ryan 1985, Deci, Koestner and Ryan 1999) as well as in field research (Frey and Jegen 2001) that external interventions, which are taken to be controlling by the persons affected, may crowd out intrinsic motivation. In contrast, external interventions which are perceived to be supportive tend to crowd in intrinsic motivation.

⁴ One might add that this also holds for relationships within firms, see Osterloh and Frey (2000).

People's actions in the public sphere are well captured by the notion of "quasi-voluntary" behavior (Levi 1997). It has been empirically shown that the extent of tax compliance can only be explained in a satisfactory way by assuming that tax payers do have some measure of civic virtue, or tax morale. Existing tax compliance in countries such as the United States or Switzerland cannot be attributed solely to the expected punishment, i.e. the probability of being caught and the size of the punishment (see Pommerehne and Weck 1996, Frey 1997). But it would be naive to assume that people are just "good" and are prepared to maximize the welfare of society. An individual is unable to know what "the welfare of society" is, and he or she is not interested in promoting abstract social goals. Rather, people are prepared to act in a non-selfish way only when they are explicitly or implicitly (i.e. via social norms) asked to do so, and when they see that relevant others also behave in that way (i.e. reciprocity is important, see the experimental evidence in Fehr and Gächter 1998).

3. *How FOCJ enhance civic virtue*

In the public sphere, quasi-voluntary behavior can only be counted on when the institutional conditions support such civic-minded action. A crucial task of institutions is thus to maintain and raise civic virtue. Institutions are therefore looked at in a fundamentally different way from traditional institutional economics (see e.g. Eggertsson 1990). Their task is no longer to exclusively establish efficiency with given individual preferences, but also to support intrinsic motivation.

FOCJ can be designed to meet these tasks. The term "functional" should be interpreted in a broad, non-technocratic way. The functions, along which the jurisdictions should extend, should be designed in such a way that the citizens' involvement and commitment to specific public activities are strengthened. Thus, for example, citizens' intrinsic motivation to protect the natural environment should be reflected in jurisdictions catering for these preferences. Similarly, FOCJ should be designed to fulfil citizens' conceptions of fairness.

The flexible political institutions in the form of FOCJ are well capable of supporting directed civic virtue for two reasons:

First, citizens are offered the possibility of getting democratically involved in, and becoming financially responsible for, political institutions catering for particular issues, for example the natural environment or social work. They therewith experience a sense

of belonging which is more difficult, if not impossible, to achieve in traditional democratic governmental institutions catering to the needs of many diverse functions, or in technocratic inter-governmental cooperation units without either democratic institutions or tax autonomy.

Second, FOCJ are designed to extend over the geographic area in which the beneficiaries of the respective public supply live. Both positive and negative spillovers are thereby minimized, which means that the citizens contributing to its finance can be certain of not being exploited by others. The crucial requirement that free-riding is prevented is better fulfilled in FOCJ than in traditional, all purpose political units.

To further consider in what ways functional, overlapping jurisdictions support civic virtue, it is useful to distinguish between (professional) politicians and citizens.

Politicians. An important supporting determinant of intrinsic motivation is a reliable feedback for one's actions (Frey 1997). But in all-purpose governments, politicians often do not know the citizens' desires among the great number of dimensions they are supposed to influence. In most circumstances, politicians are only exposed to the demands of interest groups. As FOCJ concentrate on one function, and the citizens have the possibility to express their views in referenda, the politicians experience direct reactions to their decisions, which helps to raise their inclination to be civic-minded.

Citizens. The more extensive the scope for co-determination, and the more seriously their concerns are taken in the political process, the higher the citizens' involvement tends to be. Moreover, FOCJ induce them to consider reasonable and credible alternatives to the existing situation. This focus them on policy content instead of general, non-issue directed ideologies. Collecting and evaluating information about the alternatives generates a private benefit, because it allows each individual to select the most appropriate jurisdiction to participate in. Exit and voice are in this case positively related, i.e. easing exit is no substitute, but rather a complement to voice⁵.

C. Flexible Supply of Politicians

⁵ Originally, Hirschman (1970) suggested a negative relationship, but later admitted the possibility that raising the opportunity to exit may also raise voice (Hirschman 1993).

1. *The concept*

Today, the flexibility of the suppliers of politics is heavily constrained by three kinds of prescriptions:

- *Protectionist regulations.* In almost all countries only nationals are allowed to run for political office. Moreover, the candidates often have to live in their own precinct.
- *Regulations of the "production process" of politics.* Usually only individuals can run for office. Parties are not allowed to do so, but have to nominate individuals as candidates. Moreover, parties must be non-profit organizations, and their internal structure is heavily regulated. At the same time, parties have some kind of a political monopoly, as Non-Governmental-Organizations and firms cannot become policy suppliers.
- Regulations of the "prices of politics". All the explicit prices for political services, i.e. the pay of representatives and the government subsidies for parties, are fixed by law.

These regulations weaken political competition. Therefore, they should be substituted by less constraining regulations. Deregulation of politics benefits the citizens in a similar way to how deregulation of consumer markets benefits the consumers. It strengthens the influence of the poorly organized social groups, and it enhances efficiency in all fields of politics.

The political market can be deregulated and made more flexible in various ways (for a broader account see Eichenberger 2000, 2001):

- *Decreasing protectionist barriers by allowing foreigners to supply political services.* Foreigners and non-residents are allowed to run for all offices. The effect of this deregulatory step is similar to the economic effects of free trade. It increases the supply of candidates and, thus, the competitive pressure which also makes domestic producers more efficient. The incentives for the politicians to keep their promises increase. Honesty and success in one country increase credibility and, thus, the chances of being elected in other countries. This makes it profitable to a supplier to build up an international reputation of being a high quality and credible policy producer.
- *Deregulation of the production process.* Parties and firms are allowed to directly run for political office, without nominating a specific individual (but, of course,

individuals are still allowed to run as candidates). If such a firm is elected, it can delegate whomever it likes to fulfil a task related to its mandate, i.e. it can also substitute new delegates for hitherto active ones. This deregulatory step allows domestic and foreign policy suppliers to adhere more closely to their promises. Therefore, the credibility of campaign promises is increased. The market is opened for internationally active policy suppliers, whose success depends on the professional competence of the organization as a whole rather than on the individual celebrity of their exponents. Thus, internationally reputed private organizations can directly step into politics, be they well-known consulting firms or human rights or environmentalist organizations.

- *Deregulation of the prices for political services.* The explicit revenues of politicians are increased, or even set by market mechanisms. Increasing explicit revenues crowds out implicit revenues, i.e. legal and illegal side payments by interest groups to politicians as well as political rents. This decreases the asymmetry among interest groups and increases the influence of the poorly-organized groups.

2. *Favorable effects*

The proposal for opening political markets changes the political landscape basically. In addition to the traditional suppliers of politics, internationally active policy firms can run for office. If they are elected, they can delegate domestic and foreign professionals to parliament and government. Such firms have stronger incentives to stick to their campaign promises because they are almost always engaged in an election contest somewhere in the world. Because their performance in one country influences their chances in other countries, they depend on their reputation much more than traditional suppliers. Moreover, the voters can judge internationally active suppliers much easier, because there is a larger sample of observations than for a party which is active only in one country.

Reforms that are in the interest of citizens, but which are not in the interest of the "classe politique", become more likely. An instance are constitutional reforms strengthening the influence of the citizens, e.g., federalism and direct democracy (see Kirchgässner, Feld and Savioz 1999). In a politically closed country, political parties seldom follow their promises to strengthen these institutions, because such reforms are against their own interests as soon as they are part of the majority.

Increasing explicit revenues of politicians crowds out implicit revenues. This result which has been found in empirical research on corruption (see, e.g., World

Development Report 1997) is a consequence of various mechanisms. First, explicit compensations are paid by the state. As the citizens decide on the allocation of these compensations by their vote, their political influence increases. Second, the suppliers have to build up an international reputation of not relying on implicit compensations. Third, higher explicit compensations strengthen the incentives of new firms to enter the market and to specialize in explicit instead of implicit compensations. Moreover, profit-seeking policy suppliers depend more heavily on explicit compensations than traditional parties. Fourth, high explicit compensations have an effect similar to efficiency wages. When explicit compensations increase, losing one's job becomes more expensive. Thus, politicians try to stay in government, i.e. they are willing to adapt their policy to suit the citizens' preferences. Therefore, it is well known that the higher salaries of bureaucrats crowd out corruption (see, e.g., World Bank Development Report 1997). Finally, many implicit income payments are at the limit of legality. In an open market, however, there is a higher probability that a firm's misbehavior will be brought to the political agenda by a competitor.

Sometimes, the concept of deregulating politics is criticized, claiming that it could be noxious for poor countries, because international suppliers of politics are concentrating on the rich countries. However, the opposite tends to happen. The open market for politics induces suppliers of politics to become active in those countries where they are needed most urgently. The deregulation of the explicit compensations allows them to appropriate part of the value added that they create. This stops the brain drain from, and even leads to an inflow of political human capital into, political hotspots. Therefore, there is no danger of a race to the bottom with respect to the quality of politicians. It pays for politicians to behave like turnaround managers, who enter firms with the largest unexploited opportunities. Still another incentive to supply political services in poor, troubled countries is the reputation which can be gained by doing a good job in such countries.

3. *Political Deregulation enhances civic virtue*

The *international exchange of political suppliers* in many ways contributes to bolstering civic virtue, and thus to restraining temptations to free ride. Allowing foreign politicians to compete with local politicians brings about a public supply at lower cost and more closely geared to the preferences of the population. The citizens are more satisfied with public supply, which tends to raise their civic virtue and their trust in government. The increase in explicit compensations makes politicians less dependent on well-organized interest groups and allows them to focus on the citizens' demands, i.e.

increases their self-determination, which has been identified as a main determinant of civic virtue (Frey 1997). Although higher explicit compensations may sometimes interfere with civic virtue, this effect has to be compared with the effect of implicit compensations. Implicit compensations are usually paid by specific interest groups. Therefore, they reveal no information to the politicians about the social welfare they create, which diminishes their supporting effect on civic virtue even more. At the same time, globalization of the political market opens the political process to the highly and often intrinsically motivated members of Non-Governmental-Organizations. Moreover, in deregulated political markets, institutions which strengthen civic virtue (e.g., direct democracy and federalism) have much better chances of being effectively implemented.

V. RELATIONSHIP OF THE PROPOSALS

The three proposals presented emphasize different aspects but they are also complementary. While each is advantageous on its own, together they reinforce each others' strength, which makes a combination of all three proposals especially favorable.

The reinforcing effects are clearly visible with the interaction of FOCJ and Political Deregulation. While FOCJ work better within a deregulated political market, Political Deregulation has a better chance of being accepted within a system of FOCJ. While there is a lot of resistance to the idea of free movement of politicians when it is applied to traditional all-purpose jurisdictions, many citizens have no difficulties whatsoever in imagining foreign and non-local politicians, as well as specialized firms, supplying their services to various FOCJ at the same time.

The concept of FOCJ and Political Deregulation are strongly oriented towards efficiency. They focus on the favorable consequences of competition on extrinsic incentives. But, as has been argued at length, they also have favorable effects on intrinsic motivation. Thus, they enhance the advantages of partial citizenship, which economizes on civic virtue. Moreover, all three proposals bring about a new flexibility which favors small political units. This enhances identification and thus civic virtue (see Bohnet and Frey 2000).

The generalized concept of *citizenship* strengthens these tendencies. The incentives to free ride are reduced because citizenship establishes a bond between individuals and

“their” political community. The individuals as citizens are to a considerable extent prepared to enter a “quasi-voluntary” contract: they decide of their own accord to let themselves be bound by the rules of the chosen jurisdiction. In addition to paying the taxes considered to be fair to support the public goods supplied, they are prepared to remain in the political unit as long as the conditions meet their expectations, in particular as long as they are tolerable. As has been stressed, citizenship, by its very nature, not only involves rights, but also obligations. Some of the obligations are formally laid down, but possibly the more important ones are at the moral level. They induce the individuals, who are free to choose in which organizations they wish to become a citizen, to abide more strongly to the rules than they otherwise would, and to become more immune to the temptation to free ride. This, of course, does not mean that individuals as citizens change their behavior completely and never exploit any possibility to reap a short term benefit at the expense of other citizens. But it means that they do so to a lesser extent, and, in particular, that they are more prepared to provide second level public goods in the form of sanctioning other citizens who violate the rules, and who exhibit no sense of obligation towards their political community.

Another positive influence of FOCJ and partial citizenship is that they make it easier to integrate foreigners and, thus, to support their civic virtue. The nationals will rather agree that foreigners are granted the citizenship in a specific FOCUS than at the national level.

VI. PROBLEMS IN PERSPECTIVE

It goes without saying that such new ideas cannot be implemented without any new problems. However, today’s political processes face many problems, too. Therefore, critical as well as defending perspectives only make sense if they argue from a comparative point of view. It is, e.g., often argued that, in a deregulated political market, foreign politicians possibly misuse their power. But this critique is useless if it does not analyze whether such politicians misuse power more or less than politicians in today’s regulated and protected political market. Another important aspect is that our proposals have a strong potential to endogenously cure the problems they cause. For instance, international policy suppliers have strong incentives to propose effective institutional mechanisms that constrain them from abusing their powers, because this increases their election chances. Nevertheless, there is no damage done when

governments or international organizations develop a competitive law for politics which specifies the market rules and forbids monopolies.

In the following, we will concentrate on two major reservations.

The efficiency of partial citizenship and FOCJ depends on democratic control. As we envisage a state in which each individual lives in several FOCJ and is a citizen of various political and other democratic entities, we have to consider whether the citizens are overburdened by the many elections and votes taking place in all these units. We are optimistic that this does not pose a real problem. Citizens make a great number of important economic decisions every day without being overburdened. In Switzerland, where direct-democratic institutions are prevalent, citizens go to the polls for referenda and elections on average four times a year without being overburdened. Moreover, with FOCJ and partial citizenship, there will be new institutions and rules emerging to economize on information cost. While the timing of referenda in the various units can be synchronized, politicians and interest groups will make suggestions to the citizens on how to vote. However, to make democratic control even more effective, it should be made possible that each citizen can delegate his or her votes to competing voting agents who vote on his or her behalf. In the age of electronics, delegation can be done anonymously, and the voters can renounce their mandate whenever they like, i.e. when they no longer trust their voting agents. Thus, delegated voting brings about a fruitful combination of direct and representative democracy, in which each citizen can decide whether he wants to vote himself or whether he wants to delegate the decision to a trustee. The optimal balance between direct and representative democracy emerges endogenously as a result of individual decisions.

FOCJ and partial citizenship are often said to thwart income redistribution and the provision of public goods, as long as the citizens may exit political units individually or in homogeneous groups. As we have argued, civic virtue helps to overcome this problem. But of course, free-riding will not be reduced to zero. Thus, two remarks are in order.

First, from a comparative perspective, the problem looks quite different. We have to compare the effects of free-riding with and without FOCJ and partial citizenship. From such a comparative perspective, our proposals look much more favorable. In a globalized world without FOCJ and partial citizenship, free-riders can exit a political unit which does not provide them with net benefits only by migrating. Thus, free-riding

results in geographical segregation, which often has much worse consequences for redistribution and social cohesion.

Second, it is quite easy to combine FOCJ with redistributive institutions. Rules can be implemented for fiscal equalization among FOCJ, stipulating that FOCJ with tax payers of above average financial potency have to pay a certain percentage of their potential tax income into a redistribution fund which in turn pays for “poor” FOCJ. On the other hand, rules could be made regulating exit and entry into FOCJ, and stipulating how the taxes paid to a FOCUS could be reimbursed on the tax bill of a higher level jurisdiction.

VII. CONCLUDING REMARKS

The globalization of the economy and of many other spheres of life present a great challenge to democracy. Under existing political institutions, globalization is likely to undermine democracy. Decisions will increasingly be shifted to decision-making bodies more or less isolated from the influence of the citizens.

This paper argues that such a development need not occur if the institutions of democratic governance are made more flexible. Three proposals are advanced which serve to enable the citizens to maintain, or even to enlarge, their influence in the political process. On the demand side, individuals should be able to adjust their citizenship status to varying circumstances and may establish special bonds with organizations beyond the state. On the supply side, individuals should have the authority to establish functional democratic units (FOCJ) adjusted to the geography of problems, and political markets should be opened to politicians coming from outside.

Putting any of these three proposals for institutional flexibility into practice would reduce the extent to which globalization undermines democracy. Thus, each proposal could be introduced on its own. But it has also been argued that they are complementary in important respects. In particular, they bolster civic virtue and reduce the temptation to free ride inherent in public goods supply.

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