

BEYOND DEMOCRACY
HOW VOTING WITH OUR FEET CAN MAKE THE WORLD A BETTER PLACE

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CHAPTER OUTLINE

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Chapter One: Voting with our feet

Democracy is widely regarded as the best form of government. Whenever someone criticizes it, they are usually reminded of Churchill's famous dictum: "Democracy is the worst form of government, except for all those other forms that have been tried from time to time." But few people pay attention to the crucial qualification – *that have been tried*. Churchill was careful not to rule out the possibility that there may be other systems of government that are better than democracy. It is just that they haven't been tried yet.

This book argues that there is a better form of government. To be precise, it is really a system of meta-government, since it does not specify what kind of political system is best for any particular region or polity. The idea is that the world would be better off if everyone was allowed to vote with their feet, and move to whatever polity they liked best. This is the theory of competitive governance.

Darwin famously described *The Origin of Species* as "one long argument." This book aspires to the same description. Before getting into the nitty-gritty, however, I want to give you an idea of where I'm going. In the first chapter, therefore, I'll take you on a whistle-stop tour of the whole book. This means I'll have to skimp on detail, and leave a lot of questions unanswered. I'll provide the details and answer those questions in the chapters that follow. For now, I just want to provide a broad map of the terrain.

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In a democracy, the story goes, most people get what they want, politically speaking. If a democratic country has high taxes, permits abortion, and criminalizes drug use, it must be the case that most voters want things this way.

There is only one problem with this story; it isn't true. Nor is this a mere temporary problem. It is not just that most people in a democracy *don't* get what they want. Political scientists have conclusively demonstrated that, even in the cleanest, most perfect democracy possible, most people *couldn't* get what they want.

The discovery that democracy was incapable of delivering what it promised came as a shock to the political scientists who first stumbled upon it, for they were led there by the study of something apparently trivial – the mechanism of voting. For most of history, students of democracy tended to regard voting as a merely administrative matter, something that could be left to the attention of civil servants and municipal employees. It was not until the 1940s that an obscure economist in Glasgow called Duncan Black alerted his colleagues to the devil that lay in the details

The devil had in fact been first unmasked in the eighteenth century by the Marquis de Condorcet, a French aristocrat, but it was Black who finally spelled out the full disturbing implications for democracy. Together, Condorcet and Black showed that majority rule is not as simple as it sounds, because different majorities can be in conflict with each other. There may be a majority in favor of higher taxes, and a majority in favor of legalizing abortion, and a majority in favor of banning drugs, but if these majorities are each made up of different sets of people, crafty politicians can get elected by putting together a clever manifesto that truly satisfies only a tiny minority. The majority of people will not get what want they want on most issues.

It turned out that this was just the tip of the iceberg. As economists and political scientists followed in Black's footsteps they discovered that the outcomes of democratic elections were far from being an unbiased amalgamation of individual values. On the contrary, it became clear that the noble aims of democracy were almost always entirely corrupted by horse-trading, lobbying, and a multitude of other undemocratic forces. And this wasn't just an accident of history; it was a mathematical inevitability, rooted in the very nature of voting itself. Majority dissatisfaction is the default state of democracy.

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Authoritarian societies are no better than democracies at giving most people what they want. Indeed, they are probably worse. In a democracy the citizens can at least vote bad leaders out of office. Other bad leaders will no doubt take their place, but the continual dislodging of temporary authorities does put some check on the exercise of political power, and means that different social groups can take turns in shouldering the greatest share of dissatisfaction. In authoritarian countries like China, however, the dissatisfied majority remains

more or less constant. The Communist Party keeps an iron grip on power, and prevents the circulation of unhappiness.

Yet all is not lost. Neither democracies nor authoritarian societies can give most citizens what they want, but there is a system of governance that can. And this too has been a well-kept secret, understood by political scientists for decades.

The first glimmer of hope came in the 1950s, when economists noticed that most analyses of democracy ignored migration. In other words, political scientists had treated democracies like closed systems, where entry and exit were impossible. If citizens didn't like their current leaders, they had to put up with them until the next election. Citizens could vote with their hands, but not with their feet.

When they tweaked the models to allow migration, economists discovered something amazing. In contrast to the inevitable disappointments of majority rule, it suddenly became possible for everyone to get what they wanted. If different sets of rules were implemented at different places, everyone could have the kind of society they wanted simply by moving there. Elections would be completely unnecessary.

Those in favor of higher taxes and legalizing abortion could move to a place with high taxes and legal abortions. Those in favor of lower taxes and against abortion could move somewhere else, and so on. Socialists would never have to put up with the injustices of a free market economy. Libertarians would never have to strain under the yoke of oppressive regulation. Everyone would pay as much or as little tax as they liked. And nobody would bother trying to force their own values down their neighbor's throat.

* * *

Let's imagine that the world comes to operate along these lines. Over the next century, profound political changes sweep the planet, and by the year 2100 there is a global marketplace in governance. What might the world look like? Come with me in my time machine and I'll show you.

Instead of a few hundred countries, there are over a thousand independent city-states, like a high tech version of renaissance Italy. The states differ widely in the rules they live by. Some have high taxes and generous welfare systems, like Sweden or Norway today, while others have no taxes at all, and no public services. Some permit abortion while others do not. Hard drugs are legal in some states, but completely banned in others.

Nationalism is dead and governments are seen merely as service providers, just as Friedrich Hayek envisaged when he wrote about "the transformation of local and even regional governments into quasi-commercial corporations competing for citizens." Citizens vote with their feet by moving to those city-states that offer the most attractive package of policies, services, and taxes.

A kind of free market for government leads to a wide variety of polities, each with a unique selling point aimed at a different target market. Some states lower their taxes to attract investors, while others increase public spending to project an image of social solidarity. Some states adopt sharia law to attract Muslims, while others ban all religious symbols. Some cities charge entry fees, and others pay people to immigrate, but regulatory competition ensures that there are no restrictions on emigration anywhere in the world.

This diversity is matched by a variety of political systems. Some are democracies, but there are also monarchies, oligarchies, dictatorships and theocracies. There are even lottocracies, in which the state is governed by citizens chosen at random by a kind of lottery. But even in the most authoritarian regimes, the fear of mass emigration serves as a strong check on the power of the leader, leading to more enlightened forms of absolutism.

Interspersed throughout this book you'll find pen portraits of some possible city-states of the future. These are not predictions, but imaginative exercises designed to make the ideas in this book more vivid and less abstract, and to show the range of societies that might come to exist in a world of competitive governance. [*See first example below: Abramograd*]

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Could the world really come to look like that? And would it really be a good thing if it did? There are plenty of reasons to be skeptical about the plausibility and desirability of the vision I've just sketched out. Let's take some of these objections and probe them a little.

One doubt concerns the amount of variety. Would there really be so much more political diversity in a world of competitive governance? The answer depends in part on how many dimensions political disagreements can be reduced to. If it all really comes down to the same old left-right spectrum, then perhaps the scope for diversity is severely constrained. If, on the other hand, a single left-right axis is incapable of capturing the existing variation in political beliefs, there is surely the potential for much greater variety.

Most of the researchers who have examined this issue now think that political beliefs can be mapped onto a single axis. Keith Poole and Steven Daniels find that 80-90% of all the recorded votes in the US Congress can be explained with a one-dimensional policy space. So does this mean, then, that a world of competitive governance would end up being rather similar to the one we have today?

Not necessarily. There could still be lots of variety, even if politics is fundamentally one-dimensional. The variety would come from having lots of polities placed at different points along the single dimension. There could be a whole range of city-states, each with different levels of taxation and public spending, from libertarian polities with zero tax at one end of the spectrum, to Belgium-type states with marginal tax rates of over 50 per cent at the other.

But wouldn't tax competition eliminate this variety by encouraging a "race to the bottom"? If companies and investors tended to move to places with lower taxes, wouldn't city-states be forced to keep cutting taxes until everywhere was equally tax-free, even if there were large numbers of people who still wanted to live in places with a big welfare state? Not necessarily. It is hard to know exactly how things would play out, but just as luxury goods continue to exist alongside cheaper versions in a market economy, strong welfare states could also coexist with minimalist states in a world of competitive governance. Competition can maintain and even increase diversity, if consumers want it.

Another possible objection to a world of competitive governance concerns inequality. International diversity sounds fine in principle, but what if this is just code for increasing disparity between rich and poor? Will all the wealthy people congregate in the same places, creating super-sized gated communities, while other city-states degenerate into ghastly shanty towns and slums?

To a large extent, the world is already like this. The question is whether competitive governance would make things better or worse. It could also conceivably have no effect at all on the overall level of global inequality. Again, it is hard to make definite predictions on this matter, but there are good reasons for thinking that competitive governance could reduce global poverty more quickly than the current system of state collusion. Nothing speeds up development like the free movement of labor and capital.

Nor is migration a luxury restricted to the rich. On the contrary, most migrants today are very poor. Every week, thousands of desperate people risk everything to move somewhere better. Many die in the process, drowning when the rickety vessels they sail on are shipwrecked, or asphyxiating in the back of an airless lorry.

Even if people don't segregate along economic lines, they may sort themselves out in other ways. Perhaps some city-states will come to be populated exclusively by Muslims, while others are taken over by evangelical Christians. In that case, might the whole world be ghettoized? Studies show that homogenous communities tend to become more extreme in their views, so might a world of competitive governance lead to more conflict between ever more sharply polarized states? More generally, how much war would there be in this world? Would city-states need armies, or would economic pressures render such things obsolete? War, after all, is very expensive.

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Let's suppose you buy my arguments in the previous section, and accept that a world of competitive governance would be better than the world we're currently in. I'm not saying it would be perfect – just that it would be better than this one. But this poses a conundrum. If we would all be so much better off in a world of competitive governance, why aren't we there yet? Why are we still stuck in a world with such little choice? Why is it so hard to emigrate, and why do most

countries still have such similar levels of taxation and such similar policies on everything from marriage to drugs?

Democracy itself may be the biggest obstacle. The mechanism of voting tends to anchor a society in the political middle ground. The resulting social stability has obvious advantages, in that it helps guard against political extremism. But it has disadvantages too, since it also hinders the development of better political systems.

Societies are complex systems, and like all such systems they can sometimes get stuck in sub-optimal states. In biological systems too, bad designs can persist despite their obvious disadvantages. A good example is the appendix. This organ used to play a part in our ancestors' digestive process, but now it is completely useless, and we'd be better off without it. Not only does it not do us any good, but it also occasionally does harm. Hundreds of thousands of people are hospitalized each year for appendicitis in the US alone, and several hundred of them die from it. So why hasn't natural selection eliminated the appendix? Why does it still exist?

One intriguing suggestion put forward by the evolutionary biologists Randolph Nesse and George Williams is that the appendix persists because individuals with a smaller and thinner appendix are more vulnerable to appendicitis. So the normal tendency for useless organs to atrophy away to nothing is blocked, in the case of the appendix, by natural selection itself! Perhaps this idea will turn out not to be correct, but it does illustrate how the persistence of something can conceivably be explained by the very factors that make it disadvantageous.

Democracy is like the appendix. The very thing that makes majority dissatisfaction inevitable – the voting mechanism – also makes it hard for a better political system to develop. The reforms that would be necessary to pave the way for a system of competitive governance lie well outside the safe middle ground of the median voter. Politicians advocating such reforms are unlikely, therefore, to be voted into office.

There are other obstacles in the path towards competitive governance besides the voting system. Some of these are ideological; others are political and economic.

The biggest ideological obstacle is nationalism. Nationalism encourages people to subordinate their own interests to those of some imaginary collective. President Kennedy famously urged US citizens not to think of what their country could do for them, but what they could do for their country. If you bristled earlier at the idea of governments as mere service providers, then you are probably a victim of this kind of brainwashing.

The biggest political obstacle is the United Nations and other such intergovernmental organizations. These organizations are effectively cartels whose aim is to reduce competition between members. The result of this reduced competition is, as always, homogeneous products.

For example, the UN declaration on human rights is far more encompassing than it needs to be. In stating that everyone has the right to free primary education, it goes way beyond any reasonable conception of natural rights, and betrays a hidden agenda with a definite political flavor. Likewise, in asserting the universal right to social security and to protection against unemployment, the UN elevates one particular view of the way society can be organized into a general obligation for all. Those who take a different view are, it would appear, not entitled to implement them. Libertarians, on this account, are not to be regarded merely as having different opinions, but as opposed to some basic human rights!

Or take the so-called “tax harmonization” policies enforced by intergovernmental organizations like the EU and the OECD. These policies are aimed at making taxes identical or at least very similar across all member countries. All members of the EU, for example, must have a value added tax of at least 15%. This is essentially a form of price-fixing, which is classic cartel behavior. Although the OECD pays lip-service to competition, it draws the line when it comes to taxation, where all of a sudden competition becomes “harmful,” as the title of a major OECD report published in 2007 stated in no uncertain terms.

Further evidence of the cartel-like structure of most intergovernmental organizations lies in the absence of any remedy for those who object to the government monopoly of certain services. Governments provide their citizens with a bundle of services, including identity verification (passports), protection services (police), arbitration services (civil courts), and so on. There is no reason why these services have to be bundled together, but in practice they usually are.

When a company bundles unrelated services together, this can trigger competition regulators and private litigants to file antitrust suits against them. In 1998, for example, the United States Department of Justice (DOJ) filed a set of civil actions against Microsoft alleging that the software giant had abused its monopoly power on Intel-based personal computers by bundling its flagship Internet Explorer (IE) web browser software with its Microsoft Windows operating system. The DOJ claimed that this restricted the market for competing web browsers, since these took a long time to download at the prevailing bandwidths, or had to be purchased at a store.

Unfortunately, no such remedy is available when governments do the bundling. Unlike companies, governments are sovereign – that is, there is no authority above them. Intergovernmental organizations like the UN and the World Bank only have authority over sovereign states when granted such authority by those states. The authority can be withdrawn at any time, and so really remains vested in the sovereign. The World Trade Organization (WTO) attempts to liberalize international trade, but is fairly toothless. It would be fun if someone asked the WTO to force a national government to break up the bundle of services it provides and allow third parties to provide them, but I doubt if they would get very far.

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With so many obstacles that hinder progress towards competitive governance, are we stuck with a world in which most people are disappointed? Is a mobile, diverse world in which everyone can get what they want yet another utopian fantasy, as impractical and impossible to achieve as communism? Or is there a realistic, plausible and practical route from the current world order to the one I envisage here?

There are reasons to be optimistic. The first has to do with the tendency of cartels to fracture. Game theory suggests that cartels are inherently unstable, as each member of a cartel has an incentive to cheat. Members of the Organization of the Petroleum Exporting Countries (OPEC) agree to limit their oil production to certain quotas, but these are regularly flouted, since each member can make more profit by producing more oil than their quota permits. Empirical studies have found that the cartels that were discovered in the twentieth century only lasted between 5 and 8 years.

It is hard to know how long intergovernmental cartels like the UN and the OECD will be able to keep their members in line, but sooner or later some countries will begin to break ranks. There are already some cracks in the system. Tax havens and special economic zones, for example, flout the taboo on tax competition by charging little or no tax.

More intriguing are the plans to create free cities in various parts of the world. These initiatives extend the concept of a special economic zone by increasing its size and expanding the scope of its reforms. Covering hundreds of square kilometers rather than just one or two, free cities must be large enough to accommodate millions of workers and residents. And the reforms to be implemented by free cities need not be limited to lower taxes, but can extend to more permissive immigration policies and even radical innovations in the legal system.

If the first free cities prosper, other countries will follow suit and set up their own versions. The more successful cities will push for greater autonomy, and may even secede. The cracks in the cartel of nation states will widen, and the current system may finally disintegrate altogether.

* * *

Nations are such a common feature of today's world that they often seem inevitable and natural, but they are in fact contingent artifacts with a relatively short history. Before the eighteenth century, people were generally loyal to a city or to a particular leader rather than to an imaginary community bound together by a common language, culture, or ethnicity. The only significant exception is the Jews, who formed perhaps the only true nation before the American and French revolutions created the template for the modern secular form of national identity.

Two and a half centuries later, nationalism remains the most popular world religion. Even the least patriotic citizens get caught up in its spectacular rituals, such as the Olympic games and the World Cup, waving national flags and singing national anthems. Yet these symbols of national identity were manufactured by ideologues to bolster support for their own particular conception of the state. The state is a geopolitical entity; the nation is a cultural or ethnic entity. The idea of the nation state implies that the two should coincide. Despite the ubiquity of this idea today, it is neither inevitable nor natural.

The death of nationalism would represent a major step forward for humanity. Nothing hinders international development more than the idea that people owe more duties to other members of the same imaginary community than to members of other such fictions. When Americans vote for politicians who promise to stop “American jobs” from being outsourced to China, and Chinese leaders erect import barriers, economic growth is severely impeded.

A world of competitive governance would dismantle the cumbersome restrictions on freedom of movement imposed by nation states. The whole convoluted system of citizenship, with its mystical symbols of belonging, its immigration authorities, passports and visas, would be swept away, and international travel would become as unrestricted as it was in the nineteenth century. This would truly be a cosmopolitan world.

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In this chapter I’ve given you an overview of the argument I make in this book. But this birds-eye view has necessarily been scant on detail. I’ve made a lot of unsupported statements and bold claims. In the rest of this book, I’m going to spell out each step of the argument more thoroughly, and back up the claims I’ve made with empirical evidence.

In the next chapter, I’ll go back to the beginning of my argument, and explain why democracy can’t live up to its promises. I’ll take you through the surprising developments in public choice theory that show how the mechanics of voting is not the trivial matter it may seem. No matter what voting system you choose, the same conclusion always follows: democracy can’t give people what they want.

In chapter three, I’ll set out the alternative to democracy that I propose in this book – competitive governance. I’ll introduce you to the conceptual justification for this idea – the so-called “theory of clubs” – and explain how it solves the problems that beset democracy. And I’ll sketch out a broad vision of what the world might look like if competitive governance became the dominant geopolitical system.

In chapter four, I’ll examine some of the main objections to the idea of competitive governance. I’ll address the concerns of those who worry that competitive governance would only widen the gap between rich and poor and increase global inequality. And I’ll ask whether segregation along ideological lines might lead to greater levels of extremism and potentially more conflict.

In chapter five, I'll discuss the obstacles that stand in the way of competitive governance, and suggest plausible ways to overcome them. I'll argue that democracy itself may be the biggest obstacle to change, since the mechanism of voting exerts a powerful gravitational force that hinders the development of innovative forms of governance. And I'll show that the UN and other such intergovernmental organizations are effectively cartels that perpetuate the status quo. Game theory offers some hope, however, since it suggests that cartels are inherently unstable, as each member of a cartel has an incentive to cheat.

In chapter six, I'll examine some of these "cheats" in more detail. I'll show you round some of the world's special economic zones and tax havens, and argue that, by driving a wedge between the cracks of the current system, they may represent the first signs of a global transition to a world of competitive governance. Then I'll take you to Honduras, to visit an even bolder experiment – the first free cities, which take the idea of the special economic zone to a whole new level, encompassing political, legal and administrative reforms as well as economic ones.

In chapter seven, I'll look at one of the most controversial and pressing issues in contemporary geopolitics – migration. I'll argue that migration is almost always a force for good, a point that needs emphasizing at a time when xenophobia is on the rise. In the face of well meaning but ultimately misguided opposition to globalization, we must celebrate the remarkable benefits which international migration has brought us, and fight for a more mobile world.

Finally, in chapter eight, I'll examine the current system of nation-states, and the nationalist ideology that underpins it. I'll show how irrational and atavistic these phenomena are, and end with a plea to move beyond such local thinking and embrace a truly cosmopolitan vision of the world.

All previous theories of political development have assumed that the world must eventually converge on a single form of governance. For Marx that system was communism, and when that idea was dealt a fatal blow by the collapse of the Soviet Union, Francis Fukuyama argued that it was liberal democracy. But why should we assume that everywhere must end up with the same kind of political system? Why not let a thousand flowers bloom? As the philosopher Robert Nozick argued, "There is no reason to think that there is one community which will serve as ideal for all people and much reason to think that there is not." (Nozick, 1974: 310).

Chapter Two: What's wrong with democracy?

Almost half the world's population now lives in a democracy.¹ And the number of democracies has been increasing fairly steadily since the second world war. This

¹ According to the Economist Intelligence Unit.

is a good thing; democracy is a definite improvement over the political systems that it tends to replace. It is to be hoped that the democratic revolution continues to sweep the globe, and the remaining autocratic regimes are swept away.

But it would be a shame if this really was the end of history, as the political scientist Francis Fukuyama famously argued. In an influential essay published in 1989, and in a subsequent book, Fukuyama claimed that liberal democracy was the final form of human government, the “end point of mankind's ideological evolution.” Every country would eventually become democratic, and there would be no fundamental change in political organization from then on.

This would be a shame because there are better forms of political organization that we can aspire to. This book is about one such form – competitive governance. I’ll explain in detail what this means in the next chapter, but in order to appreciate why it is better than democracy, it is first necessary to understand the problem that it solves. So in this chapter I’m going to explain what exactly is wrong with democracy.

My thesis can be stated very simply; democracy claims to give most people what they want, politically speaking, but it cannot live up to this promise. The default state of democracy is, in fact, majority *dissatisfaction*.

This may seem counterintuitive at first. Surely, you might think, majority rule guarantees majority *satisfaction*. If society implements whatever policy most people vote for, then by definition most people *will* get what they want, right?

Wrong.

The argument is complex, so let’s take it step by step. We’ll start by imagining a direct democracy, in which voters decide each policy by means of a referendum. In other words, in this toy world there are no elected politicians who decide on behalf of the people; the people themselves decide each issue by a vote of the whole population. Perhaps they vote online to make things easier. You’ll see that even in this simple case, most people will end up dissatisfied. Later on in this chapter, I’ll show that we get the same result when we add elected politicians to the picture. No matter whether we are dealing with a direct democracy or a representative democracy, we still end up with a dissatisfied majority.

Suppose the electorate must choose between two alternative policies, one which legalizes all abortion and one which criminalizes it. If a vote is taken, and the policy with more votes is implemented, then most people will get the policy they voted for. But this doesn’t mean most people will be satisfied, because there are many intermediate policies between complete legalization and a complete ban that were simply not on the table. Some voters may prefer to allow abortion only in certain cases, for example. These voters will be dissatisfied no matter *what* the outcome of the election is, if they are forced to choose between a total ban and complete legalization.

We cannot solve this problem simply by allowing voters to choose between three alternative policies, for as soon as we have more than two alternatives on the table, we cannot guarantee that any policy will be backed by a majority of voters. If voters can choose between more than two alternative policies, the most popular policy might receive less than fifty per cent of the votes. Such a policy could not be implemented under a system of majority rule.

Simple majority rule, in which policies must win more than half the votes before they can be implemented, is the most popular voting system in the world. It governs decisions in all sorts of bodies, from parliaments and local councils to multinational companies and the UN General Assembly (though not in the UN Security Council, where approval must be unanimous). It is widely thought to be just and fair. It does, however, require that voters be presented with a choice between just two alternatives, so as to ensure a clear winner.

But who, exactly, decides what this selection will be? Not the voters, of course. To determine the nature of the two policies that voters must choose between by a prior vote would be a recipe for eternal regression. The process would get so bogged down in the initial phase of deciding what the available policies are that voters would never get to vote on the issue itself. Hence the need for some prior, nondemocratic process that boils down the range of alternative policies to just two options for voters to choose between. This process is known, in the jargon, as setting the agenda.

We'll come back to the crucial issue of who sets the agenda later. For now, I want to explore another question: once the nature of the two alternative policies has been determined, which policy will win?

To approach this question scientifically, it helps to imagine all the possible policies along a line with the extremes at either end. Recall the various policies on abortion, for example. We can arrange these policies in a line from the most restrictive to the most permissive. At one end of the line is complete legalization, and at the other end is a total ban. Various intermediate policies can be placed at various points in between. Setting the agenda involves selecting just two of the possible policies for voters to choose between.

Or consider how much tax should be collected. Countries vary widely in how much tax they collect as a percentage of gross domestic product (GDP). In 2012, for example, this figure ranged from just over 1 per cent in the United Arab Emirates to almost 70 per cent in Kiribati, an island nation located in the Pacific. These are the end points of the tax policy scale in today's world. All other countries occupy intermediate points between these two extremes. If the total tax revenue were to be decided by a simple majority, voters would have to be presented with a choice between just two of these points.

Voters can be arranged a line too, with the most extreme voters at each end. The median voter is the person in the middle of this line. And in a majority voting system, this person's vote is decisive. Whenever voters must choose between just two policies, and people vote sincerely, the policy favored by the median

voter wins. If there was a vote on how much of the budget should be spent on defense, the result of the election would be determined by the voter located half way between the most pacifist voter and the most hawkish.

This is known the median voter theorem, and it was first discovered by the economist Duncan Black in 1948. In that year, Black published a short but brilliant paper in which he showed that, under certain plausible conditions, all political outcomes in a democracy must reflect the preferences of the median voter. For the first time, a regularity had been discerned amid the chaos of democratic politics. Thus was born the new discipline of public choice theory.

To see why the median voter always gets what he or she wants, consider the graph below, which is taken from Black's original paper (figure 2.1). The horizontal axis represents the spectrum of alternative policies, and the vertical axis how much each voter wants a given policy to be implemented. The various points O_1 , O_2 , etc, represent the optimal policies for each of five voters, and the curves represent the feelings of these five voters about each of these alternative policies. The fact that these curves are bell-shaped indicates that the further away a policy is from a voter's ideal, the less he or she likes it. If a policy is very far away, the curve dips under the horizontal axis, which means the voter actively *dislikes* it.

Now suppose voters must choose between the policies lying at points O_3 and O_4 on the policy spectrum. It is clear that O_3 will win because it will be voted for by voters one, two and three, while O_4 will only be supported by voters four and five. In fact, O_3 will win against any other policy.

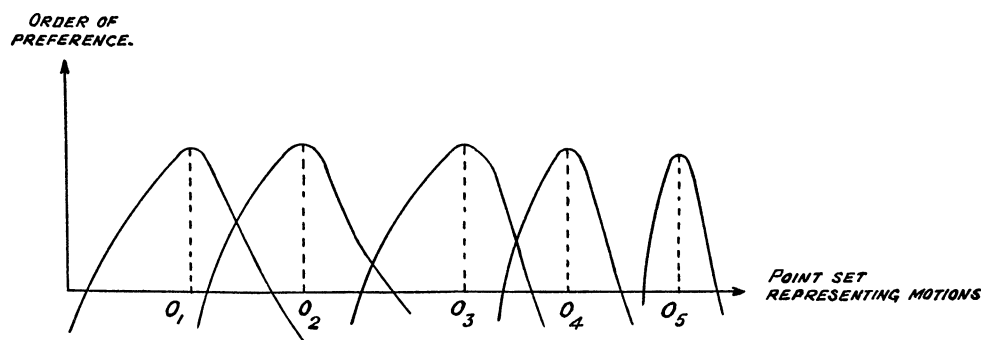


Figure 2.1: Duncan Black's graph for visualizing voter preferences

But what guarantees that O_3 will be one of the two policies that voters must choose between? What is there to prevent voters being forced to choose between, say, O_2 and O_5 ? In that case, policy O_2 would win, and the median voter would not get what she wants.

The answer depends how the agenda is set. As already noted, setting the agenda involves boiling down the range of alternative policies to just two options for voters to choose between. When the number of voters is small, such as in a committee or a board meeting, they can set agenda themselves by voting on a series of motions. After some initial discussion, someone proposes a motion and

a vote is taken. After further discussion, another motion (an amendment) might be moved. If so, the original motion and amendment are placed against each other in a vote. One of these two motions is defeated, leaving a single motion in the field. A further amendment might then be moved, and a further vote taken to decide between the survivor of the first vote and the new motion, and so on.

Let's imagine that voter two proposes the first motion. He naturally proposes his ideal policy, which is O_2 . Voter five now suggests an amendment, which is of course *his* ideal policy, O_5 . When these policies are placed against each other in a vote, policy O_2 wins. At some point in this process, voter three will propose a motion in favor of O_3 and when she does so, O_3 will win. And this motion will defeat any other motion which is subsequently placed against it. In other words, this way of setting the agenda guarantees that, sooner or later, voters will be faced with a choice involving policy O_3 , so the media voter will always get a chance to vote for her ideal policy. And from then on, no other policy can dislodge it.

In Figure 2.1, voter number three will be happy with the outcome. The other four voters will all be somewhat dissatisfied, but to different degrees. Voters one and five will be much more dissatisfied than voters two and four. More generally, the more extreme a voter's political beliefs are, the more dissatisfied they will be in a democracy. In fact, figure 2.1 understates this phenomenon by making all the curves the same height and shape. In reality, those with extreme views would feel much happier to see their favorite policies implemented than those with moderate political beliefs, so the curves of voters 1 and 5 should have higher peaks. Extremists also tend to be more dissatisfied than moderate voters when policies they don't like are implemented, so their curves should also have steeper slopes. Not only will extremists always be dissatisfied in a democracy, but they will be much *more* dissatisfied than the moderates would be if, by some miracle, an extremist policy was implemented.

In other words, the median voter theorem doesn't just predict that, in a majority voting system, everyone except the median voter will be unhappy with the outcome; it also says something about *how* dissatisfied the other voters will be. This will not be apparent when one simply counts the votes. Under a one-person one-vote system, there is no way a voter can express how strongly he or she cares about political issues. Hence it is easy to underestimate the amount of dissatisfaction that occurs in a democratic system.

More than six decades have elapsed since Black published his incisive analysis. Yet it is still widely ignored, and many people still believe that democratic outcomes must reflect the will of the people. This is testimony to the enduring power of the myth of voting, the quasi-religious idea that the alchemy of elections transforms thousands of individual votes into a single authoritative stamp of approval. Or, as the philosopher Friedrich Hayek put it:

It appears that we have unwittingly created a machinery which makes it possible to claim the sanction of an alleged majority for measures which

are in fact not desired by a majority, and which may even be disapproved of by a majority of the people... [Law & Liberty vol.3 p.6]

* * *

So far, we've been looking at single-issue politics in a direct democracy. That is, we've been imagining a toy world in which the people themselves decide each issue by a vote of the whole population. We've seen that even in this simple case, the median voter gets what she wants, and everyone else ends up with varying degrees of dissatisfaction. When we now consider the more realistic case of representative democracy, we'll see that we still get the same result.

Direct democracy is only possible when the number of voters is small. The toy world depicted in figure 2.1 has only five voters, who can set agenda themselves in the way just described, namely by voting on a series of motions. When there are more than just a few voters, however, the agenda cannot be set in this way. Even when there are only a few hundred voters, it would be far too time-consuming for everyone to present their views on every issue, however concise they were. When there are millions of voters, as there are in most contemporary democracies, the agenda must be set by political parties or individual candidates who compete to represent the voters in an elected government. But the median voter hypothesis still applies.

To see why, suppose that there are two major candidates or parties competing in an election, and that the winner will be given the power to decide policies until the next election. If voters vote sincerely, then the candidate who is closest to the median voter always wins the election, for the same reason that the median voter's ideal policy always wins in a direct democracy. Both candidates will therefore attempt to occupy the middle ground, and select platforms that are relatively close to the median voter's preferred policies. The result is that the positions of both candidates converge toward the median voter's ideal policy.

The economist Harold Hotelling was perhaps the first to observe the tendency for political parties to converge. In a paper published in 1929, he noted that:

The competition for votes between the Republican and Democratic parties does not lead to a clear drawing of issues, an adoption of two strongly contrasted positions between which the voter may choose. Instead, each party strives to make its platform as much like the other's as possible. Any radical departure would lose many votes, even though it might lead to stronger commendation of the party by some who would vote for it anyhow. [Stability in competition, p.54]

In the limit, both candidates adopt the same platforms, and both candidates receive the same number of votes. However, in that case it doesn't matter which candidate wins the election. In either case, the median voter gets exactly what she wants, just as she did under direct democracy.

Or does she? In a representative democracy, voters do not get to vote on each issue, as they do in a direct democracy. Rather, they have to choose between different candidates or parties who take different positions on a whole raft of issues. In other words, voters must choose between different manifestos rather than individual policies, and there is only a small range of manifestos to choose from (often just two). It is doubtful, therefore, that any of the available manifestos represents the ideal preferences of more than a small minority of voters, if any. This opens up much greater scope for voter dissatisfaction than in the case of direct democracy. Thus the entrance of representatives into the democratic process weakens the relationship between the preferences of the median voter and final outcomes, making it likely that voter dissatisfaction will be even greater than in a direct democracy.

Who gets to decide what is in each manifesto? The politicians, of course. And how do they make these choices? In a groundbreaking book published in 1957, the political scientist Anthony Downs argued that “parties formulate policies in order to win elections, rather than win elections in order to formulate policies.” (Downs, 1957: 28). This is a very Machiavellian view of politics, in which politicians care far more about gaining and retaining power than about the issues on which they campaign. And this is precisely what makes it such a powerful theory.

Downs argued that politicians cobble together any old manifesto that enables them to win more votes than their rivals. In other words, what politicians really care about is getting elected; policies are merely a means to this end. Crafty politicians can take advantage of the fact that voters must make trade-offs between the various issues they care about by putting together a clever manifesto that caters to several minorities rather than to the median voter.

For example, suppose that most people want high taxes, and most people think abortion should be legal. However, the minority in favor of low taxes cares more passionately about this issue than about abortion, and the minority in favor of banning abortion cares much more about this than about the level of taxation. In this situation, a clever politician might be able to win an election by promising to reduce taxes and ban abortion. By gaining the support of several minorities who care passionately about single issues, he could defeat a rival candidate who simply appeals to the less passionate majorities.

To see how this might work in practice, let's suppose that voters fall into three main groups: moderates, evangelicals, and libertarians. Moderates are the largest group, forming 48 per cent of the electorate, while evangelicals and libertarians constitute much smaller groups, with each accounting for only 26 per cent of the electorate. Moderates believe in a strong welfare state and are happy to pay the high taxes necessary to finance it. Moderates also think abortion should be legal. Evangelicals also want a strong welfare state and are prepared to pay for it, but they are passionately opposed to abortion. Libertarians think abortion should be legal, but are firmly opposed to high taxes.

There is therefore a majority of 74 per cent in favor of high taxes (the moderates and the evangelicals), and a similar majority in favor of legalizing abortion (the moderates and the libertarians). But if candidate A campaigns on a high tax, pro-choice platform, he might nevertheless be defeated by a rival candidate B who runs on a low tax, pro-life platform. Candidate A would win the moderate vote, since his platform accords perfectly with their preferences. But moderates only account for 48 per cent of the electorate. If the evangelicals and libertarians both vote the other way, candidate B will win the election with a 52 per cent majority.

Unlike candidate A, whose platform suits the moderates perfectly, candidate B is not the ideal choice for anyone. The evangelicals don't like his policy on taxation, and the libertarians don't like his policy on abortion. But unlike the moderates, who care equally about both issues, the evangelicals and the libertarians are single-issue voters. The evangelicals care much more about banning abortion than about maintaining a strong welfare state, and the libertarians care much more about reducing taxes than they do about keeping abortion legal. The evangelicals will therefore trade away their votes on taxation to the libertarians in exchange for the libertarian votes on abortion, and vice versa. By catering to these two minorities, candidate B can win on a platform that, as a whole, is not supported by anyone.

According to the investor Edward Conard, Ronald Reagan won the US presidential election in 1980 by doing something very similar. Before Reagan's victory, marginal income tax rates had stood at 70 per cent or higher for over four decades. Democrats won elections by appealing to moderates and evangelicals, who were both in favor of high taxes. Republicans could only win by appealing to moderates and libertarians, and had to keep taxes high to keep the moderates on board. But everything changed in 1973 with the passage of *Roe v. Wade*, a landmark decision by the US Supreme Court on the issue of abortion. Or so Conard argues, in an intriguing piece of political analysis.

Before 1973, abortion was illegal throughout the US, though some states permitted it in cases of rape and incest. In *Roe v. Wade*, the Supreme Court declared these laws to be unconstitutional. But, as Conard points out, *Roe* does more than legalize abortion; it legalizes controversial third-term abortions and takes away the electorate's right to vote on this issue by making third-term abortions a judicial right rather than a legislative decision. This was too much for the evangelicals, so when, at the next election, Reagan endorsed the pro-life movement, many of them abandoned their traditional support for the Democrats and voted Republican instead. Conard concludes that "this marriage of convenience between odd bedfellows – pro-choice fiscal conservatives [libertarians] with pro-life social conservatives [evangelicals] – brought the larger pro-investment faction in this coalition to power." During his two terms in office, Reagan was thus able to cut marginal tax rates from 70 per cent to under 30 per cent. Without the support of the evangelicals, previous Republican presidents had had to accept high tax rates in order to keep the support of the moderates.

The precise details of this story are more complex than my figures suggest. The proportion of evangelicals is more or less right – polls suggest that 25 per cent of US voters identify themselves as evangelical Christians. But prior to *Roe* not all evangelicals voted Democrat; they were, in fact, split 15 per cent Democrat and 10 per cent Republican. When Regan endorsed the pro-life movement these percentages reversed. And the faction I have called “libertarian,” and which Conard refers to as “pro-investment tax-cutters,” probably accounts for around 35 per cent of the electorate rather than the 26 per cent of my example. Nevertheless, the broad outlines are the same; *Roe* drove enough evangelicals over to the Republican camp that Regan was able to win a majority without pandering to the moderates on the issue of taxation.

Regan won power by taking advantage of the fact that some minorities feel so strongly about one issue that they will support a candidate for taking their position on it regardless of his position on other issues. This makes good politics, but it undermines the idea that democracies satisfy the wishes of the majority. The philosopher Friedrich Hayek made this point forcefully in the year before Regan was elected. Indeed, his observation seems to describe Regan’s winning platform pretty well:

It would be mere pretence to describe a programme of action thus decided upon in a bargaining democracy as in any sense an expression of the common opinion of the majority. Indeed, there may exist nobody who desires or even approves of all the things contained in such a programme; for it will often contain elements of such contradictory character that no thinking person could ever desire them all for their own sake... [Law & Liberty vol.3 p.14]

The phrase “bargaining democracy” captures nicely the mechanism at work here. The best way to get elected may *not* be to adopt the position on each issue that has majority support, but to put together a clever manifesto that caters to several minorities. The wily politician thus tempts those various minorities to strike a Faustian bargain with one another, thereby forming a coalition that brings him to power. Coalitions like this are possible because voters don’t just disagree about what the ideal policy is on a given issue, but also disagree about the relative importance of the issues themselves.

* * *

Our discussion of representative democracy has so far been restricted to a two-party system. What happens if there are more than two parties? In that case, there must be some mechanism for ensuring that the winner represents the majority of voters, for otherwise they cannot claim that the policies they implement have a proper democratic mandate. One way to achieve this is to organize a second election if no party obtains in a majority in the first. In the second round, voters can only vote for the two parties with the highest number of votes in the first ballot.

Another way to ensure that the winner represents the majority of voters when there are more than two parties is to have some kind of proportional representation, and permit the parties to form coalitions. After the votes have been counted, the parties negotiate with each other until some of them succeed in forming a coalition whose members together received over half of all the votes.

Other systems are also possible, but the same problem affects them all; by adding extra complexity to the voting process, they tend to increase the amount of voter dissatisfaction.

Take the runoff system for example. Let's suppose that there are four candidates in the first round, and they receive the following shares of votes (table 2.1):

| CANDIDATE | % OF VOTES |
|-----------|------------|
| A | 25 |
| B | 30 |
| C | 40 |
| D | 5 |

Table 2.1: An imaginary election with four candidates

Since no candidate has won a majority of votes, a runoff is organized between B and C, since they received the highest numbers of votes in the first ballot. Let's say that all those who voted for A in the first round now vote for B, and all those who voted for D in the first round now vote for C. Candidate B will win the runoff with 55 per cent of the vote. He can therefore claim to have a democratic mandate to implement his choice of policies. But something feels wrong about this claim, since he only won 40 per cent of votes in the first round. The extra votes he gained in the runoff were, so to speak, given grudgingly. His democratic mandate is an artifact of the two-stage voting procedure, and not the genuine expression of the will of the majority.

Similar considerations apply to the formation of coalitions. If the imaginary election in Table 2.1 was operating under a system of proportional representation, rather than a runoff system, the four candidates would have to negotiate with each other until some of them succeeded in forming a coalition. But several coalitions are possible: AB, AC, and BC are all combinations that account for over half of all the votes. Yet presumably each would have a different mix of policies. Whatever the will of the majority is, it surely cannot be three different things at once. So the democratic mandate claimed by at least two of the possible coalitions, and perhaps by all three, must be also be an artifact of the particular voting procedure, and not the genuine expression of the will of the majority.

When there are more than two parties, then, the government that emerges after an election will depend not just on the way that people vote, but also on a series of nondemocratic decisions, such as choice of voting system and (if a coalition must be formed) the negotiating tactics of politicians. Of the various voting

systems, none is obviously superior to the others; they all have pros and cons. Yet they all lead to different results. If each of these different results can all claim a democratic mandate, then it would appear that this mandate is a sham, and that the “will of the people” is a fiction designed to lend legitimacy to a particular political system, just as the “divine right of kings” was once supposed to justify monarchy, or “the dictatorship of the proletariat” to justify communism.

The truth is that there is no such thing as the will of the people. People want different things, and their views are too diverse to warrant the attribution of any single, consistent set of political aspirations even to “the majority,” let alone to “the public” as a whole. It is misleading, therefore, for any political party ever to claim that they are acting on behalf of the people, or that they have a democratic mandate. This is no more convincing than the claim that God has chosen someone to be an absolute monarch.

In reality, democracy is all about compromise. Different social groups effectively trade votes with each other in order to get some of what they want. Hopefully, everyone ends up partially satisfied, though that is by no means guaranteed. Nobody, however, is all that happy with the outcome.

We can do better. In the next chapter, I’ll introduce you to a new kind of political system in which everyone can potentially get exactly what they want. This is the system of competitive governance.

CHAPTER THREE: The solution – competitive governance

The various models of democracy that we looked at in the last chapter are very simplistic. Duncan Black’s model, for example, assumes that for any set of policies there is some way of ordering them along a single continuum. Anthony Downs’ model assumes that candidates are interested only in winning elections, and will adopt any policy that wins them more votes. Neither of these assumptions is strictly correct.

The same is true of all scientific models. Like maps, they are useful precisely because of what they leave out. When Galileo rolled brass balls down the groove he had cut in a piece of wood, he was able to learn something about the free fall of bodies in space because his model stripped away the things he wasn’t interested in, such as friction.

Sometimes, however, scientists may leave out something crucial. In that case, the simplification has gone too far, and the model may prevent us from seeing a vital aspect of the phenomenon under investigation.

Such is the case with the models of democracy in chapter two; they all ignore migration. In other words, they treat democracies like closed systems, where entry and exit are impossible. If citizens don’t like their current leaders, they

have to put up with them until the next election. Citizens can vote with their hands, but not with their feet.

But what if we relax this assumption? What if we tweak the models to allow migration? The first person to explore the consequences of free movement between polities was a geographer by the name of Charles Tiebout. And the consequences turned out to be huge; simply by allowing migration, it suddenly became possible for everyone to get what they wanted. If different sets of rules were implemented at different places, everyone could have the kind of society they wanted simply by moving there.

Those in favor of higher taxes and legalizing abortion could move to a place with high taxes and legal abortions. Those in favor of lower taxes and against abortion could move somewhere else, and so on. Socialists would never have to put up with the injustices of a free market economy. Libertarians would never have to strain under the yoke of oppressive regulation. Everyone would pay as much or as little tax as they liked. And nobody would bother trying to force their own values down their neighbor's throat. Tiebout had found a solution to the inevitable disappointments of majority rule.

Tiebout was not thinking about international migration when he published his far-reaching paper in 1956. In his model, citizens move from one local area to another within the same state. But there is nothing about the model that restricts its application to local migration. It can equally well be applied to movement between different states. Providing there are enough states, and they are sufficiently different, international migration can solve the problems with democracy and allow everyone to live in the kind of society they want.

The last condition is crucial. Tiebout's solution only works if there is a state to suit everyone's tastes. How many states would be necessary to meet this condition? This depends on how many issues people disagree about, and on how many opinions there are on each issue. If there are just two issues, and there are just two opinions on each issue, there would only need to be four states for everyone to be happy. For example, let's suppose people agree about everything except taxation and abortion. When it comes to taxation, some people are in favor of high taxes and others in favor of low taxes. With abortion, some people think it should be legal and others don't. In this toy world, all the political possibilities are covered with four types of state, as shown in figure 3.1.

| | | Tax | |
|----------|-----|-----|------|
| | | Low | High |
| Abortion | Yes | 1 | 2 |
| | No | 3 | 4 |

Figure 3.1: A full range of states in a 2x2 world

In reality, of course, things are much more complex. For one thing, we haven't specified what "low tax" and "high tax" actually mean. How much is low? To

make this model more realistic, we should put numbers on things. We might specify tax revenue as a percentage of GDP, for example. And there are, of course, more than two opinions on complex issues such as tax and abortion. If we increase the number of opinions to just three on each issue, there would have to be nine states for everyone to be happy, as shown in figure 3.2.

| | | Tax | | |
|----------|------|-----|----|----|
| | | 10 | 30 | 50 |
| Abortion | Yes | 1 | 2 | 3 |
| | Some | 4 | 5 | 6 |
| | No | 7 | 8 | 9 |

Figure 3.2: A full range of states in a 3x3 world

This is still too simplistic, of course. There are more than three opinions on the overall level of taxation, and more than one intermediate position between permitting all abortions and outlawing them completely. And people disagree about other issues besides tax and abortion. If people disagreed about three issues, we would need a three dimensional space to represent all the possible polities, like the cube in figure 3.3 below. If there were more than three issues that people disagreed about, we would not be able to represent the space of possible polities by means of a drawing, but we could extend our model mathematically without any difficulty, since math is not restricted to what can be represented in 3D visual space. Thus political space might be a four- or five-dimensional hypercube, or even more complex. To cater to everyone's political tastes, there might have to be a very large number of different states.

In the limit there might have to be one state per person, which is of course ridiculous, as there is a certain minimum population beneath which a state ceases to be a viable geopolitical entity. If there aren't enough other people who share your particular views on the full range of political issues to constitute a viable state, you'll have to settle for a less than ideal polity. So if political tastes are really that diverse, there will inevitably be some level of dissatisfaction even in a Tiebout world. But the amount of dissatisfaction would almost certainly be less than under the current system, where the vast majority of the world's population is forced to live with many policies that they fundamentally disagree with. Tiebout's solution does not guarantee universal satisfaction, therefore, but it does suggest a way of getting closer to this ideal. The greater the number of states, and the greater the variety among them, the closer we would get.

On the other hand, the number of states needed for a world of competitive governance to function adequately might be less than we think. If all politics really boils down to the familiar left-right spectrum, then perhaps the scope for diversity is severely constrained. What if most of the political hypercube is uninhabited? What if, in practice, people only choose between a tiny proportion of the possible political alternatives? Recall figure 3.1 for example. It is theoretically possible to imagine states in which there are high taxes and

abortion is illegal, but it is hard to imagine a significant proportion of people wanting to live with such a combination of policies. Hence cell 4, and perhaps also cell 1, might not be viable options in the real world. In such circumstances, we could reduce the two-dimensional matrix in figure 3.1 to the one-dimensional spectrum in figure 3.4. One dimension would suffice to capture the diversity of political opinion, since opinions on taxation and abortion are correlated; those who want high taxes tend to be pro-choice, while those who are pro-life tend to want low taxes.

To illustrate this point further, take the cube in figure 3.3. What if opinions on all three issues were correlated, so that if you knew what a person thought about one issue you could predict what they thought about the other two? In that case, the only cells representing common political opinions would all be located along a diagonal line stretching between two opposing corners, and we could once again reduce this complex matrix to a one-dimensional spectrum.

Just how many political dimensions there are in real life has been the subject of substantial investigation by political scientists. Most of the researchers who have examined this issue now think that political beliefs can be mapped onto a single axis. Keith Poole and Steven Daniels, for example, find that 80-90% of all the recorded votes in the US Congress can be explained with a one-dimensional policy space.

See remarks on p.242 of Public Choice III about dimensionality in politics (paragraph 4, also the references cited in footnote 12 which suggest that most observers identify at least two salient dimensions to the policy space, at least outside the US)....

* * *

In a Tiebout world, there would be no need for elections. Elections are only necessary when people disagree. But if there were enough sufficiently different states for everyone to be able to move to a state that implemented all the policies he or she believed in, then there would be no political disagreement within any particular state. Hence the whole costly machinery of democracy could be dismantled, and states could be run just like businesses. To be more specific, they could be run like private clubs. Private clubs are businesses in the sense that they aim to maximize profit, not welfare. But they maximize profit in a particular way – namely, by developing a kind of community. In a Tiebout world, therefore, states would essentially become become profit-maximizing community developers.

States are already like clubs in that they provide resources and services to their citizens. Just as members must pay a fee to access the resources and services provided by a club, citizens must pay taxes. Taxes can be thought of, then, as membership fees charged by those peculiar clubs otherwise known as states.

The analogy breaks down in several crucial respects. For one thing, modern democratic states supposedly aim to maximize the welfare of their citizens, and not to make a profit. Modern states tend to be much larger than private clubs, so there are correspondingly fewer of them. States are therefore less subject to the competitive pressures that lead to efficient production decisions in clubs. Competition for members keeps private clubs on their toes, but states do not compete nearly so fiercely for citizens. On the contrary, immigration is often heavily restricted.

In short, it is much more expensive and difficult to change citizenship than it is to leave a golf club and join another one. In a Tiebout world, however, this difference would disappear. States would no longer be *somewhat like* private clubs; they would simply *be* private clubs, in every respect. Exit costs would be minimal, and membership fees would be set by market forces.

* * *

What might a Tiebout world look like in practice? Let's exercise our imaginations and put some flesh on the bare bones of his idea. What if profound political changes swept the planet, and a global marketplace in governance evolved?

Fast forward to the year 2100. Instead of a few hundred countries, there are now over a thousand independent city-states. Nationalism is dead and governments are seen as mere service providers. Citizens vote with their feet by moving to those city-states that offer the most attractive package of policies, services, and taxes. Competition for migrants leads to a wide variety of polities, each with a unique selling point aimed at a different target market. Some states lower their taxes to attract investors, while others increase public spending to project an image of social solidarity. Some states adopt sharia law to attract Muslims, while others ban all religious symbols. Some cities charge entry fees, and others pay people to immigrate, but regulatory competition ensures that there are no restrictions on emigration anywhere in the world.

This diversity is matched by a variety of political systems. Some are democracies, but there are also monarchies, oligarchies, dictatorships and theocracies. There are even lottocracies, in which the state is governed by citizens chosen at random by a kind of lottery. But even in the most authoritarian regimes, the fear of mass emigration serves as a strong check on the power of the leader, leading to more enlightened forms of absolutism.

This world might seem chaotic and unprincipled to some, but to others it will seem ideal. Among those who would embrace this vision would surely be the philosopher Robert Nozick, whose definition of utopia closely resembles a world of competitive governance:

"Utopia will consist of utopias, of many different and divergent communities in which people will lead different kinds of lives under different institutions. Some kinds of communities will be more attractive to most than others; communities will wax and wane. People will leave

some for others or spend their whole lives in one. Utopia is a framework for utopias, a place where people are at liberty to join together voluntarily to pursue and attempt to realize their own vision of the good life in the ideal community but where no one can *impose* his own utopian vision upon others.” (Nozick, 1974: 312)

As Nozick emphasized, this diversity would allow a kind of natural selection to take place, in which “[s]ome communities will be abandoned, others will struggle along, others will split, others will flourish, gain members, and be duplicated elsewhere.” (Nozick, 1974: 316). We might expect this process to lead to improved forms of governance as people search through the state space of alternative polities. New forms of governance hitherto untried might be invented, and novel modifications of old ones might be implemented. Indeed, this capacity for learning and evolution is a significant advantage of competitive governance over previous political ideals.

Previous political philosophies have assumed that the world must eventually converge on a single optimum mode of governance. They differ greatly on what form this will take – for Marx it was communism, while for many people today it is liberal democracy – but they all agree that once this ideal is attained, there will be no more political development. We will have reached what Francis Fukuyama called “the end of history,” the “end point of mankind's ideological evolution.”

Competitive governance, on the other hand, makes no such claim. It does not assume that there is any such thing as an ideal political system towards which the world will gravitate, and then stop evolving. On the contrary, it provides a framework for continual progress, in which different communities can seek forms of governance that are ever better suited to their own political tastes.

The social commentator Virginia Postrel argues that dynamism and stasis represent conflicting views of progress, and that is these poles rather than the traditional left and right that increasingly define our political and cultural debate. Competitive governance falls squarely on the side of dynamism in favoring an open-ended world where creativity and enterprise generate progress, often in unpredictable ways. Dynamists are united not by a single political agenda but by an appreciation for such complex evolutionary processes as scientific inquiry, market competition, artistic development, and technological invention.

On the other side, Postrel identifies a mishmash of odd bedfellows: conservatives and socialists joining together to oppose international trade and immigration; bureaucrats and anti-globalization protesters standing shoulder to shoulder against tax havens and privatization. Some prefer a pre-industrial past, while others envision a bureaucratically engineered future, but all share a devotion to what Postrel calls “stasis,” a controlled, uniform society that changes only with permission from some central authority.

To aspire to competitive governance is to doubt that we know what the “right kind” of future looks like. It is to welcome what Postrel calls “an order that is

unpredictable, spontaneous, and ever shifting, a pattern created by millions of uncoordinated, independent decisions.”

* * *

The vision of competitive governance I have outlined here treats states simply as service providers. To be more specific, states are merely entities that provide those peculiar services called public goods, in return for those peculiar fees called taxes. This is, I take it, a relatively benign view of the state. There are other, less charitable ways of thinking about the state; it can be seen, for example, as a way of forcibly extracting wealth from some citizens and transferring it to others. But a kleptocracy would not survive for very long in a world where people are free to shop around for the polities they like best, so it seems reasonable to treat states as relatively benign providers of public goods when discussing competitive governance.

Public goods are usually defined as goods that are nonrival and nonexcludable. Nonrivalry means that it doesn't hurt to share. Stories are nonrival because infinitely many people can potentially enjoy the same story without detracting from each other's enjoyment of it. Pizzas are unlike stories since there is a limit to how many people can share them. A morsel of pizza is completely rival, since it can only be enjoyed by one person.

Goods are nonexcludable when it is impossible or too expensive to stop people from enjoying them. You can't expect to make money by charging people for nonexcludable goods, because there is no way to stop people enjoying them for free. A large fireworks display, for example, will be visible to people for miles around, and so is nonexcludable. You could, however, charge people to see a small fireworks display in your garden, providing you had high enough fences, since those who didn't pay to come in would be unable to enjoy the display.

The classic example of a public good is national defense. A national army is nonrival because everyone in the country enjoys the same level of protection without detracting from each other's enjoyment of it. It is also nonexcludable because there is no way to protect some citizens against foreign aggression without also protecting the others. Hence you can't expect to make money from charging people for providing national defense; some people will be happy to enjoy the benefits of protection without paying for it, and the army will be underfunded.

Economists usually assume that, if a society wants public goods, they must be provided by the state since, unlike private companies, states are not limited to collecting voluntary payments; they can also collect forcible payments known as taxes. If you don't want to buy something from a private company, you can simply walk away. But if you don't pay your taxes, you may be arrested and sent to prison. Unlike companies, then, states (and other protection rackets) can *force* people to buy the services they provide by threatening to lock up or harm those who don't pay.

Without states, then, it would appear that people would have to go without public goods like national defense. But this argument breaks down when you realize that nothing that states provide truly meets the definition of a public good. In the strict sense of the term, public goods don't exist. Take national defense, for example. It is not completely nonrival, because there is a limit to how many people can share an army of a given size; it costs more to defend a population of ten million than it does to defend a population of one million. Nor is national defense completely nonexcludable; if attacked, those citizens living near the border could be sacrificed to protect those living in the heartland.

The same is true of all other so-called public goods, such as property rights, the legal system, police forces, fire services, and public highways. Everything is rival to some extent (except stories), and everything is excludable. The marginal cost of guaranteeing property rights to one more citizen may be negligible, but it is not zero. Roads must be repaired more frequently when there are more drivers, and eventually become congested. Poor people may be effectively excluded from defending their property rights if they cannot afford to hire lawyers, and you can charge people to use public highways by building toll booths. Rivalry and excludability are therefore matters of degree rather than all or nothing.

Nevertheless, property rights, police forces, and public highways are not purely private goods either. It usually makes more sense to club together to pay for these things, rather than for each person to build his own roads, or hire his own bodyguards. Some very wealthy people may be able to pay for their own private armies, but for most of us the only way to defend ourselves against armed aggression is by sharing the benefits and the costs of a "public" army.

It would seem, therefore, that we need a third category to cover these intermediate cases lying between the extremes of purely private and purely public goods. It was the economist James Buchanan who supplied the missing link, in 1965, with his "theory of clubs."

* * *

A club is a group of people who cooperate to pay for and enjoy some good, such as a swimming pool or a golf course. In order to prevent overcrowding, there must be some way of preventing non-members from using the facilities, such as a wall or bouncers. Club goods are therefore excludable by definition. They are nonrival up to a point, but sooner or later crowding effects detracts from everyone's enjoyment of the shared resource. If one other person joins you in the pool, it doesn't stop you enjoying your swim, but if a few dozen other people dive in, it's time to get out and head for the sauna.

Buchanan observed that there exists some optimal number of members for almost any conceivable club. This number is partly determined by how wealthy the members are, of course; rich people tend to prefer golf clubs with fewer members, for example, while poorer people must put up with more crowded facilities. Private goods can be thought of as club goods for which the optimal number of members is one; a morsel of pizza is a private good because the

optimal sharing arrangement is a single person. Public goods can similarly be thought of as club goods for which the optimal number of members is infinite. This way of putting things makes it clear that, while some goods and services can be classified as purely private, few if any can be regarded as purely public. Even in the case of goods characterized by a high degree of “publicness,” such as armies, there comes a point when the cost of extending coverage to another person exceeds the net benefit of doing so.

Figure 3.1 illustrates this point. Line B represents a pure public good, in which the addition of another consumer always increases the total benefit to the other members, but never increases the total cost. The fact that line B keeps on rising forever indicates that the optimal number of members in a club for producing and sharing a pure public good is infinite. No club can have more members than the total population available, of course, so in practice the optimal number of members is P , the total population.

Line A represents a club good, in Buchanan’s sense of the term. The fact that it peaks at N_0 , which is less than P , indicates that the optimal number of members is less than the total population. If property rights, police forces, and other things that economists tend to think of as public goods are, in fact, better described as club goods, then there is no reason to assume that they must be funded by taxes. They could perfectly well be provided by private clubs collecting voluntary payments from their members.

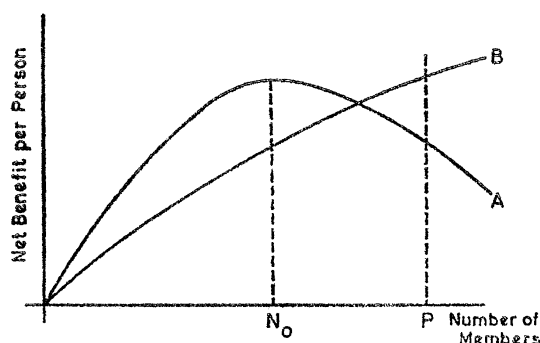


Figure 3.1: Optimal club size (from Pauly, 1967: 316)

* * *

What has all this got to do with states and competitive governance? The answer is that states can be thought of as clubs, and citizens as members. The analogy is not perfect because citizenship is mostly involuntary, but this is precisely why the analogy is useful, for it enables us to better comprehend how a Tiebout world would differ from the world as it is today. Simply put, a Tiebout world would be one in which the analogy between states and clubs was perfect. It would be a world in which states really are no more, and no less, than private clubs.

Buchanan's observation about optimal club size would therefore apply to states too, a point that Tiebout himself also glimpsed. In his discussion of local governments, Tiebout noted that there was an optimal community size, and that this optimum was "defined in terms of the number of residents for which this bundle of services can be produced at the lowest average cost." [Tiebout 1956: 419]. The same would apply to states in a Tiebout world, and this explains why a Tiebout world would be composed largely of *city-states*, like Renaissance Italy writ large. The optimal club size for providing most of the services currently provided by nation states is much smaller than the number of citizens in most states. If migration became much easier than it is today, competition for citizens would force states to shrink in order to become more efficient; communities above the optimum size would, Tiebout argued, encourage emigration to reduce congestion. Those below optimum size would seek to attract new residents to lower average costs, while those at an optimum would try to keep their populations constant [Tiebout 1956: 420]. Instead of becoming ever more integrated into larger regional groupings such as the European Union, Nation-states would fragment into city-states, each with their own hinterland, but probably not into even smaller units.

* * *

URBANIZATION:...The first cities appeared in the Middle East around 10,000 years ago [CHECK DATE]. Thus began what Shlomo Angel has called "the Urbanization Project." [See Dr. Shlomo Angel's website at NYU Wagner: <http://wagner.nyu.edu/angel> and his book, *Planet of Cities*. Cambridge: Lincoln Institute of Land Policy, 2012.] Around half the world's population now lives in cities. By the end of this century, it is estimated that this figure will rise to between 70 and 80 percent. In other words, we will see more urbanization this century than in all of history to date. But what will these cities look like? Will they be surrounded by slums and shanty towns like present day Rio de Janeiro? Or will we discover a way of accommodating the new city-dwellers in pleasant and enjoyable surroundings?....

* * *

A Tiebout world could not exist without the free movement of people. Citizens must be able to leave states they don't like and join states that they prefer. We'll discuss immigration later, but for now I want to focus on the other side of the story – emigration. The right to leave one's own country is something that many people today take for granted, but there is a long history of states treating their citizens as virtual prisoners.

Emigration was almost completely banned by the Soviet Union, except for some very limited family reunification and a few forced deportations. Some people managed to sneak across the border into Romania and Manchuria, but the bulk of the population remained essentially captive. The official newspaper *Pravda* once described the decision to emigrate as "unnatural and like burying someone alive." Those wishing to leave were viewed as traitors.

The situation in North Korea today is somewhat similar. Emigration is heavily restricted and unauthorized departure is regarded as an act of treason. Those who are caught emigrating or helping others to cross the border illegally are sent to forced labor camps where rates of torture and death are notoriously high.

Strict emigration controls are essential if rulers wish to implement deeply unpopular policies. Without such controls, the threat of mass emigration would force the rulers of states like North Korea to pay more attention to the wishes of their citizens. As the economist Albert Hirschman pointed out, *exit* can thus serve as a mechanism for expressing preferences in addition to, or instead of, various forms of communication such as voting (which Hirschman collectively refers to as *voice*).

The most conspicuous use of exit to express preferences occurs in shopping. When a customer doesn't like the goods on sale in one shop, he can simply walk out and go to another one. The same applies to the virtual world of shopping online; if you don't find what you want for sale on one website, there are many other sites vying for your custom instead. Retailers employ many methods to understand what customers want, including surveys (which count as a kind of *voice*), but they don't usually ask customers to vote. Elections are unnecessary to ensure customer satisfaction because exit serves as a highly effective alternative to voice for expressing consumer preferences.

Elections would be similarly unnecessary in a Tiebout world. Exit would function as an effective alternative to voice at the state level just as it does at the level of individual retailers. Tiebout had already hinted at this when he referred provocatively to "consumer-voters" in his original 1956 paper.

There is something both deeply unsettling and deeply liberating in this view of citizen as consumers. For those who think, like President John F. Kennedy, that you should ask not what your country can do for you, but what you can do for your country, it smacks of selfishness and disloyalty. But for others who are skeptical of such political rhetoric, it can be refreshing to reconceive our relationship to the services traditionally provided by governments as one of consumers. Perhaps we need to reclaim the word consumerism from the new puritans who define it as an "emphasis on or preoccupation with the acquisition of consumer goods" (Oxford English Dictionary, 1960) and restore its original sense as "advocacy of the rights and interests of consumers" (Oxford English Dictionary, 1915). Politics is the last bastion to hold out against the consumer revolution.

* * *

In chapter two, I argued that democracy cannot make good on its promise to give most people what they want, politically speaking. In this chapter, I have discussed an alternative political system that could do better than democracy in this respect. But what is the evidence? Would people really be happier in a world

of competitive governance than in a world consisting entirely of liberal democracies?

It is, of course, still too early to tell. But there is already some evidence from the US that suggests that a Tiebout world would indeed lead to greater levels of satisfaction. In the Detroit metropolitan area there are many more local communities than in other parts of Michigan, and citizens of Detroit have a correspondingly greater choice between different local tax/expenditure packages. It is therefore easier for citizens of Detroit to move to a community that supplies the bundle of local public services that they prefer. As a result, the local communities in the Detroit metropolitan area are more homogenous than those in other parts of Michigan; the residents tend to agree more about how much the local government should tax and spend, and local governments respond accordingly. It is not surprising, therefore, that people in the Detroit metropolitan area are more satisfied with their local tax/expenditure packages than their fellow Michiganders. [Gramlich & Rubinfeld, "Micro estimates of public spending demand functions and tests of the Tiebout and median-voter hypotheses," *Journal of Political Economy* 90 (3): 536-60, 1982.]

The same logic explains why citizens are more satisfied in smaller jurisdictions. When jurisdictions are smaller there are more of them, and hence a greater variety of public service provision. It is therefore easier for people to move to the jurisdiction that suits their taste for public services. Smaller units are therefore more homogeneous than larger ones, and this in turn leads to more favorable evaluations of public services.

There is some evidence, then, that the basic assumptions of competitive governance are correct. People do choose to move in response to differences in local tax/expenditure packages, and this migration process sorts people into communities with relatively homogenous political tastes. Since political tastes are linked to income, this migration also sorts people into communities with similar incomes; the wealthy tend to move away from high taxes, while the poor move towards high welfare payments.

Does this mean that a world of competitive governance would be even more unequal than the world we have today? We'll look at this question in chapter four, where I outline some of the main objections to competitive governance and try to answer them. But for now we might simply retort: maybe, but so what? If people are happier living with like-minded neighbors with similar incomes, why shouldn't they? No one is obviously harmed. Besides, the alternative is to restrict peoples' freedom of movement, and this seems like a more fundamental evil than inequality.

Notwithstanding the concerns about inequality, it seems that a world of competitive governance, with a wide variety of political systems and diverse tax/expenditure regimes, would indeed lead to greater satisfaction than a world composed entirely of democratic states.

Chapter Four: What's wrong with competitive governance?

Could states really turn into private residential clubs? And would it really be a good thing if they did? There are plenty of reasons to be skeptical about the plausibility and desirability of the vision I've set out in chapter three. In this chapter I'll take some of these objections and argue that none of them is fatal.

Let's start with the deepest and most philosophical objection of all. My argument has been that democracy can't give most people what they want, politically speaking, while competitive governance can. This is to assume that democracy is merely a means to an end, and can therefore be dispensed with if there is a more efficient means.

Yet some people value democracy as an end in itself. They view political participation, and the process of deliberation, as inherent aspects of the good life. Such people want democracy for its own sake, because they think that it is just a *good thing* for everyone to spend part of their time debating the direction of their community. As the philosopher Jason Brennan has observed, this attitude can sometimes take on an almost religious quality, in which democracy is seen a way of life and political debate takes on a sacred quality (Brennan 2012: 69). For Aristotle, deliberative political participation was the highest human end.

If there were enough people who thought like this, a world of competitive governance could accommodate them by including some democratic states among the variety of polities on offer. But this would not be good enough for the true believers. They want the whole world to be democratic, in the same way that Muslim extremists want everywhere to be part of a single global caliphate.

Competitive governance is opposed to any kind of uniformity, whether it be Marxist, Muslim, democratic, or any other totalizing worldview. If some people want to live in a democracy, that's fine. But why should others be forced to do so if they don't want to? What is so great about political debate anyway? Why should every decision be subject to discussion? As Brennan argues, "one of the greatest freedoms of all is not having to justify yourself to others. If your entire life resembles a committee meeting, you are not free." [Jason Brennan, *Libertarianism: What Everyone Needs to Know*, Oxford, 2012]

* * *

Another important objection to competitive governance concerns inequality. International diversity sounds fine in principle, but what if this is just code for increasing disparity between rich and poor? Would all the wealthy people congregate in the same places, creating super-sized gated communities, while other city-states degenerate into ghastly shanty towns and slums?

Many economists assume that the wealthy tend to move away from high taxes, while the poor move towards high welfare payments.² And there are well-documented instances when this has happened. In the late 1960s, for example, New York City widened access to welfare, and increased the benefits. As a result, a wave of low-income migrants, mostly black and Puerto Ricans, moved to New York City from all over the US.

Welfare payments to the new immigrants imposed a huge burden on the municipal budget (Hans-Werner Sinn...eg. ch.1 pp.4-5). The city's debt increased rapidly, and in 1975 the banks refused to include city securities in their portfolios. As a result, the city had to implement drastic spending cuts to regain its credit standing, and the welfare program was heavily curtailed.

The influx of poor people into New York City in the late 1960s was due to the fact that the new tax/spending regime redistributed money from the rich to the poor. But it is not necessarily the case that public spending involves taking money from the rich and giving it to the poor. Sometimes it can be the other way round. Some local public services such as education, police, and libraries may represent a pro-rich transfer, while others such as parks and street repairs may be neutral (see studies cited in Gramlich & Rubinfeld 1982: 549-50). The wealthy might move *into* a high tax/spend regime and the poor *away from* it if the local public services were predominantly pro-rich, and/or taxation were regressive.

So the crucial question may not be the overall level of taxation and public spending, but what kinds of public service are funded and whether these tend to benefit the rich or the poor. If public spending benefits the poor, more poor people will move in, and rich people might leave. This is unsustainable in the long run since it erodes the tax base; you can't transfer wealth from the rich to the poor if all the rich people disappear. Hence it would seem that migration would impose severe constraints on the amount of redistribution that each state could undertake in a world of competitive governance.

In a worst-case scenario, welfare benefits might be slashed repeatedly until they were completely eliminated, in what has been dubbed a "race to the bottom." [see p.507, Jan K. Brueckner, "Welfare Reform and the Race to the Bottom: Theory and Evidence," *Southern Economic Journal* 66(3), 505-525 (2000).] If governments think that generous benefits attract welfare migrants, then each state may try to undercut the others in order avoid becoming a welfare magnet. For this to occur, it is not necessary that welfare migration is a real threat; all that is required is that governments perceive it as such. States could hold such a perception even if welfare migration were mostly imaginary. (Brueckner 2000: 508). But what if there were large numbers of people who still wanted to live in

² These are precisely the outcomes hypothesized by Oates (1977, p. 5): "an aggressive policy to redistribute income from the rich to the poor in a particular locality may, in the end, simply chase the relatively wealthy to other jurisdictions and attract those with low incomes." Wallace E. Oates, "An Economist's Perspective on Fiscal Federalism," *The Political Economy of Fiscal Federalism*, edited by Wallace E. Oates. Lexington, Mass.: Heath, 1977.

places with a big welfare state? Would we then end up with large numbers of dissatisfied people, just as we do in democracies? If so, then the main claim of this book – that more people would get what they want, politically speaking at least, in a world of competitive governance than in a world of democratic states – would look shaky.

To refute this objection, it is necessary to distinguish between two types of political dissatisfaction. Most of the dissatisfaction that inevitably arises in a democracy can be cured by segregation. Neither pro-life nor pro-choice people need live in a state that imposes policies regarding abortion that they strongly disagree with, since each group can live in a different state whose policies they favor. But redistribution is different. If one sector of society emigrates because it is fed up with being taxed to subsidize the other group, the dissatisfaction does not disappear; it merely shifts to the other group, who can no longer receive the subsidies.

The dissatisfaction is now somewhat different, however. Before they emigrated, the group being taxed was dissatisfied by a *political* act – a tax policy imposed on them without their consent. After this group emigrates, the group that was previously being subsidized is dissatisfied by an *economic* phenomenon – the inequality that occurs naturally in any market economy. And this distinction is crucial, because in the political struggle some people can force others to transfer wealth against their will, while in the economic struggle this is not the case. This is exactly what Plato feared about democracy, when he warned in *The Republic* that democratic leaders would “rob the rich, keep as much of the proceeds as they can for themselves and distribute the rest to the people.” [Republic 565a]

The question then arises as to whether anyone has the right to rob Peter to pay Paul. It is one thing if the rich are happy to fund welfare benefits for the poor, but quite another if they are forced to fund such benefits whether they like it or not. Sometimes inequality must be tolerated because the alternative is even worse. Given a choice between economic inequality and forcible redistribution, the former is the lesser of two evils. If a world of competitive governance is more unequal than a world full of democracies, because the poor can no longer outvote the rich and thus force them to subsidize welfare payments, so be it. The world would be, on balance, a better place, because political coercion is a greater evil than economic inequality.

Besides, economic inequality hurts most when rich and poor live cheek by jowl. If rich and poor lived in different places, the poor would not be reminded of their relative poverty quite so often. Out of sight is usually out of mind. Inequality *between* states might increase in a Tiebout world, but there would be less inequality *within* states, and it is the latter that leads to strong feelings of relative deprivation.

* * *

Competition to avoid becoming a welfare magnet is not the only thing that could drive a race to the bottom. States could also be forced to slash public spending

because of tax competition. Since companies and investors tend to move to places with lower taxes, city-states might be forced to keep cutting corporate taxes until tax rates were universally low. Those who believe in a large public sector would have nowhere to go, and there would therefore be a lot of political dissatisfaction just like there is in democratic states.

If this argument were correct, it would seriously weaken the main claim of chapter three – namely, that there would be far less political dissatisfaction in a world of competitive governance than in a world full of democracies. In the absence of a time machine, though, it might seem hard to evaluate it. What evidence can we bring to bear on it, given our current state of knowledge?

First, there is some evidence that tax competition has indeed driven down corporate tax rates in the past few decades. Following the dramatic fall in tax rates from 46% to 34% which the United States decided on in 1986, for example, many other countries undertook similar tax reforms of their own. As a result, by 1992 the average tax burden which the then fifteen members of the European Union imposed on US firms operating within their borders had fallen by more than 12 percentage points (see figure 4.1).

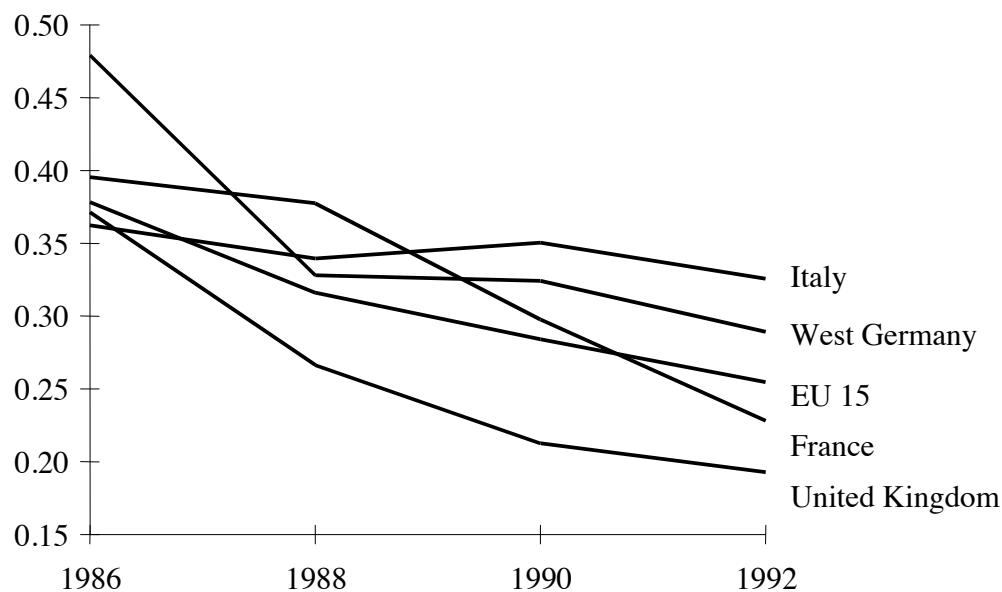


Figure 4.1 Average tax burden on subsidiaries of US corporations in Europe after 1986 US tax reform (taken from Hans-Werner Sinn 2002 Figure 1.2).

It is worth noting, however, that despite all this competition, corporate taxes have not yet fallen to zero in any of the major economies. Hence the phrase “race to the bottom” may overstate the issue.³ Although tax competition does drive rates down somewhat, it does not necessarily lead to a draconian tendency to slash rates to zero.

³ As Jan K. Brueckner (2000: 507) points out in “Welfare reform and the race to the bottom: theory and evidence, *Southern Economic Journal*, 66 (3) 505-525.

To understand why not, it is necessary to probe some of the assumptions that underpinned the earliest models of tax competition, and which first gave rise to fears of a race to the bottom. These early models assumed that capital was mobile but labor was not, and assumed that public services were financed by a tax on capital. When these assumptions hold true, jurisdictions cannot raise taxes to finance additional public spending for fear that capital will relocate to other jurisdictions as a result, thereby shrinking the jurisdiction's tax base. But this downward pressure on public spending can disappear when these assumptions are relaxed. Tax competition can lead to different outcomes, then, depending on how easy it is for consumers/workers to migrate, and what kind of taxes the government imposes. If public goods are financed by a head tax, for example, rather than by a tax on capital, high levels of investment may be compatible with high levels of public spending.

The details can get very complex, and it is precisely this complexity that undermines any straightforward predictions about the results of tax competition in a Tiebout world. Fears of a race to the bottom may be misplaced because states can compete on a whole variety of features in addition to taxation, and these different kinds of competition involve various trade-offs. For example, tax competition can be balanced by expenditure competition, whereby states compete to provide public goods that increase the productivity of business, such as roads, railways, reliable legal systems, and communication networks. Competition among states would only push tax rates to zero if taxes provided nothing of value, but if they are used to pay for valuable public goods, then competition could lead to even greater differences between tax regimes than we see today. Just as luxury goods continue to exist alongside cheaper versions in a market economy, strong welfare states could also coexist with minimalist states in a world of competitive governance.

For example, some states might slash capital taxes to attract capital intensive industries, with the result that their residents would enjoy higher incomes, but few public services. Others might keep capital taxes at a higher level, thereby attracting labor intensive industries; their residents would have lower incomes, but better public services.⁴ If some states are inhabited largely by people who rent their homes from absentee landlords, tax competition can even lead to increases in public expenditure, because the consequent fall in house prices acts as a mechanism for shifting a portion of the burden of redistribution from tenants to property owners, a phenomenon known as "tax exporting." Thus even such things as the proportion of residents who are renters can be a major factor affecting the amount and kind of public services provided by a state in a Tiebout world.⁵

⁴ This is the situation envisaged in a model developed in J. D. Wilson (1987), "Trade, capital mobility, and tax competition", *Journal of Political Economy* 95: 835-856.

⁵ This is the main conclusion of Dennis Epple and Thomas Romer, "Mobility and redistribution," *Journal of Political Economy*, 99 (4): 828-858.

The complexities are such that it is hard to know exactly how tax competition would play out in a Tiebout world, but there are good reasons to believe that strong welfare states could coexist with minimalist states. Contrary to what you might think, competitive governance would not necessarily lead the universal erosion of public services.

* * *

The objections to competitive governance that we've looked at so far in this chapter have both focused on migration. When discussing the effects of competition to avoid becoming a welfare magnet, it was the immigration of poor people seeking more generous benefits that concerned us. In the case of tax competition, it was the emigration of rich people and companies seeking lower marginal tax rates. But these two kinds of migration are likely to be dwarfed in a Tiebout world by a third kind – migration in search of higher wages.

This kind of migration would actually reduce the amount of global inequality. If a poor man from Morocco triples his income by moving to France, the inequality *between* these two countries may increase or decrease, but the amount of global inequality almost certainly declines, because there is one less poor man in the world, and one more man with a medium-sized income. Does it really matter if inequality between states increases in a Tiebout world, if both inequality *within* states and *global* inequality simultaneously decline?

But what about the effect of this kind of migration on those who *don't* emigrate? If those who emigrate tend to be more highly skilled and talented people, their departure might reduce the productivity and the welfare of those left behind. This is the so-called “brain drain” that development experts often worry about. They fear that migration can lead to another kind of inequality – an inequality of skills – that can be just as harmful as purely economic inequality, and which may indeed further deepen the latter. However, these fears may be misplaced, for they fail to take into account the fact that the existence of an emigration option for some people can act as an incentive for many more people to invest in their education. As the economist Michael Clemens has pointed out, “when emigration to high-wage countries becomes possible, even when it is costly and uncertain, the expected value of human capital rises for all potential migrants.” [p.5, Michael Clemens, 2011, “Economics and Emigration: Trillion-Dollar Bills on the Sidewalk?” *Journal of Economic Perspectives*, 25(3): 83–106] If the only jobs available are low-skilled jobs at home, it's not worth spending time and money acquiring complex skills. But if it is possible to find a better job in another country, it makes more sense to invest in training and education. Since not all of those who were thus encouraged to invest will actually leave, allowing greater immigration can thus actually lead to an *increase* in the level of education in the country of origin. Far from leading to a brain drain, economic migration can lead to a brain *gain* in both the destination country and the origin country.

* * *

Questions about inequality cannot be separated from questions about the overall level of wealth. It matters not just how we carve up the pie, but how big the pie is to start with, and whether or not it expands. A smaller section of a bigger pie can leave more on your plate than you formerly had with a bigger slice of a smaller pie, and when the pie is expanding my gain need not be your loss. Both of our incomes can increase in a dynamic economy; even if mine grows more rapidly than yours, yours still grows. A less equal but more prosperous world could be a better place for everyone than a more equally impoverished one.

Nothing speeds up development like the free movement of labor and capital. In the past few decades, capital has become much more mobile. The progressive liberalization of cross-border trade and investment has been the single most powerful driving force behind economic growth and rising living standards. Yet the gains from eliminating migration barriers dwarf the gains from eliminating other types of barriers by several orders of magnitude. For the elimination of trade policy barriers and capital flow barriers, the estimated gains amount to less than a few percent of world GDP, but Michael Clemens estimates that the estimated gains from eliminating barriers to labor mobility are in the range of 50–150 percent of world GDP. (Clemens p.2) In other words, if everyone who would like to migrate were allowed to do so, worldwide income would be trillions of dollars greater than it is today.

Hence even if inequality between countries were to increase in a Tiebout world, it might not matter if poorer countries became richer at the same time. Would citizens really care about the increasing relative poverty of their country if they also experienced significant gains in their standard of living?

* * *

Most of the objections we have considered so far in this chapter concern problems that might arise if the rich and the poor end up living in different states. But in a Tiebout world, people may segregate along other lines besides wealth. Religion is one obvious candidate for such a noneconomic dividing line. Perhaps some city-states will come to be populated exclusively by Muslims, while others are taken over by evangelical Christians. Attitudes to other things such as the environment and new technology may also polarize people.

In the 1970s the economist Thomas Schelling famously demonstrated that even a mild preference for living near people who are like you in some way is enough to cause strong segregation. Schelling used pennies and dimes to represent different social groups, such as blacks and whites, or Catholics and Protestants, and used a chess board to represent a city, with each square of the board representing a house or a lot. To begin with Schelling would place the coins randomly on the board, but then he would move them around according to certain rules that specified whether a particular person was happy in his current

location. If the person was unhappy, Schelling would try to move him to an adjacent location where he was happier.⁶

When people move to new locations, however, they might tip the balance of the local population, prompting others to leave. A cascade of further moves thus ensues, but eventually the people settle in to a new arrangement where everyone is happier. The new arrangement is, however, much more segregated than the original one, with large clusters of pennies divided neatly from large clusters dimes. Even when each dime would be happy if just 30% of its neighbors were also dimes, the dimes end up with other dimes constituting around 70% of their neighbors. So relatively small individual preferences for similar neighbors can lead to significant overall segregation

Demographic trends in the US seem to bear out Schelling's model. Americans, it seems, are increasingly choosing to live among like-minded neighbors. Conservatives prefer to live near other conservatives, and liberals near liberals. This can be seen very clearly from the country's changing electoral geography. When Jimmy Carter won the 1976 presidential election with 50.1% of the popular vote, some 26.8% of Americans were in "landslide counties" in which Mr Carter either won or lost by 20 percentage points or more. Over the next three decades, the proportion of Americans who lived in such landslide counties nearly doubled, rising to 48.3% when George Bush narrowly won re-election in 2004.⁷

There is something deeply worrying about this trend. Surely it's better to live in diverse communities than homogenous ones? For many years, politicians in Europe expected diverse social groups to live happily together, but after the financial crisis of 2008 things began to change. In October 2010 The German chancellor, Angela Merkel, claimed that the country's attempts to create a multicultural society had "utterly failed". A few months later the British Prime Minister David Cameron and the French President Nicolas Sarkozy echoed her comments. "We have been too concerned about the identity of the person who was arriving and not enough about the identity of the country that was receiving him," said Sarkozy in a television interview in which he declared the concept of multiculturalism a "failure." This political rhetoric was no doubt aimed at courting anti-immigrant opinion, which tends to deepen during economic depressions, but it also points to a deeper truth – that social and cultural diversity is often more conducive to tension than to rational debate.

If people are happier living with like-minded neighbors, they surely have every right to do so, and it is wrong for politicians to impose high-minded aspirations of universal brotherhood upon them. There is, however, something more worrying about segregation than merely the death of a utopian ideal. Mixed company moderates, but like-minded company tends to polarize. Heterogeneous

⁶ Thomas C. Schelling, "Dynamic models of segregation," *Journal of Mathematical Sociology* 1: 143-186 (1971).

⁷ <http://www.economist.com/node/11581447> Accessed 15 October 2012. See also See <http://www.amazon.com/The-Big-Sort-Clustering-Like-Minded/dp/0547237723>

communities restrain group excesses; when a group is ideologically homogeneous, its members tend to grow more extreme. US voters in landslide districts tend to elect more extreme members of Congress. Republican-appointed judges vote more conservatively when sitting on a panel with other Republicans than when sitting with Democrats. Democratic judges become more liberal when on the bench with fellow Democrats.

The legal scholar Cass Sunstein has explored this phenomenon by means of an ingenious experiment. In 2006 he asked citizens from two cities in Colorado to deliberate on three of the most contested issues of the day: global warming, affirmative action, and civil unions for same-sex couples. The two cities were Boulder, which is predominantly liberal (in the American sense of the term, i.e. broadly left of center), and Colorado Springs, which is largely conservative. The participants were first asked to record their views on each of the three issues individually and anonymously. Then they were assembled into small groups consisting entirely of people from the same city, and asked to reach a consensus on each issue through discussion and deliberation. Finally, they recorded their personal views again, to see if these had changed in the course of the discussion.

The result? On all three issues, both liberal and conservative groups became more unified and more extreme after talking to one another.⁸ Before deliberation, there was considerable overlap between the views of those from Boulder and those from Colorado Springs. After discussing things with their fellow citizens, however, the overlap was much smaller. Deliberation sharply increased the differences between the two groups.

The political scientist Russell Hardin has argued that the same phenomenon plays a significant role in maintaining ideological purity in terrorist groups. Most terrorists are neither stupid, insane or badly educated. The real problem, Hardin claims, is that their information comes from a very restricted set of sources, all of which confirm their extremist beliefs. They live in self-reinforcing information cocoons in which they listen only to one another. As a result, any lingering doubts disappear, and it becomes easier to think of those who disagree with them as hopelessly confused, or downright evil.

If homogenous communities tend to become more extreme in their views, might a world of competitive governance lead to more terrorism, or even more overt conflict between ever more sharply polarized states? Would city-states need armies, or would economic pressures render such things obsolete?

This is perhaps one of the most difficult things to predict about a Tiebout world. On the one hand, no democracy has gone to war against another democracy (yet), so if the number of democracies were to shrink, as it most surely would in

⁸ David Schkade, Cass R. Sunstein, and Reid Hastie, "What happened on deliberation day? (June 2006). U Chicago Law & Economics, Olin Working Paper No. 298; AEI-Brookings Joint Center Working Paper No. 06-19. Available at SSRN:

<http://ssrn.com/abstract=911646> or <http://dx.doi.org/10.2139/ssrn.911646>

a world of competitive governance, this might lessen the forces that restrain conflict.⁹ On the other hand, war is very expensive, so if states were run more like businesses, they might conceivably be more sensitive to the economic costs of warfare than are current states.

One thing that does seem clear is that international relations would be substantially different in a world of competitive governance. They might be more peaceful, or more violent, but it is hard to say which way things would turn out. What would be the role, if any, of intergovernmental organizations in such a world? Could the UN survive? In the next chapter we'll see how the United Nations and other such organizations tend to act as cartels that reduce competition between member states. This may play well in today's world, where migration is heavily restricted, but it would be less tenable in a world where competition for immigrants was the order of the day.

Chapter Five: Obstacles

Let's suppose you buy my arguments in chapter four, and accept that a world of competitive governance would be better than the world we're currently in. I'm not saying it would be perfect – just that it would be better than this one. But this poses a conundrum. If we would all be so much better off in a world of competitive governance, why aren't we there yet? Why are we still stuck in a world with such little choice? Why is it so hard to emigrate, and why do most countries still have such similar levels of taxation and such similar policies on everything from marriage to drugs? In this chapter I'll examine some of the principle obstacles that stand in the way of competitive governance, and speculate about how these might be overcome.

Democracy itself may be the biggest obstacle. As we saw in chapter two, when we looked at the median voter theorem, the mechanism of voting tends to anchor a society in the political middle ground. The resulting social stability has obvious advantages, in that it helps guard against political extremism. But it has disadvantages too, since it also hinders the development of better political systems.

Societies are complex systems, and like all such systems they can sometimes get stuck in sub-optimal states. The very thing that makes majority dissatisfaction inevitable in a democracy – the voting mechanism – also makes it hard for a better political system to develop. The reforms that would be necessary to pave the way for a system of competitive governance lie well outside the safe middle

⁹ On the theory that democracies do not go to war with each other, see: http://en.wikipedia.org/wiki/Democratic_peace_theory For an alternative theory, see Erik Gartzke's claim that economic freedom (as measured by the Fraser Institute Economic Freedom Index) is about fifty times more effective than democracy in reducing violent conflict. See http://en.wikipedia.org/wiki/Perpetual_peace

ground of the median voter. Politicians advocating such reforms are unlikely, therefore, to be voted into office.

For example, one route to competitive governance may begin with the secession of a few cities from their parent nations, or in the creation of new cities from scratch operating under different rules than those in the rest of the country. It is hard to imagine elected politicians getting away with such things, however, even if they wanted to, as we'll see in chapter six. The only historical precedents so far have occurred in autocratic regimes, where leaders do not have to worry about re-election. The wave of special economic zones in China in the 1980s, beginning with Shenzhen, was driven by a small cadre of unelected officials headed by Deng Xiaoping. It may therefore be easier to go from autocracy to competitive governance than to get there from democracy. Democracy may turn out to be a historical cul-de-sac, a place that looks pleasant enough from far away, but that doesn't lead anywhere.

* * *

There are other obstacles in the path towards competitive governance besides the voting system. Some of these are ideological; others are political and economic. I'm going to focus on the political and economic obstacles in this chapter, but before I do I'd like to flag the main ideological obstacle, which I'll discuss in more detail in chapter eight.

The biggest ideological obstacle to competitive governance is nationalism. Nationalism encourages people to subordinate their own interests to those of some imaginary collective. President Kennedy famously urged US citizens not to think of what their country could do for them, but what they could do for their country. If you bristled earlier at the idea of governments as mere service providers, then you are probably a victim of this kind of brainwashing.

Nations are such a common feature of today's world that they often seem inevitable and natural, but they are in fact contingent artifacts with a relatively short history. Before the eighteenth century, people were generally loyal to a city or to a particular leader rather than to an imaginary community bound together by a common language, culture, or ethnicity. One significant exception is the Jewish people, who formed perhaps the only true nation before the American and French revolutions created the template for the modern secular form of national identity.

Two and a half centuries later, nationalism remains the most popular world religion. Even the least patriotic citizens get caught up in its spectacular rituals, such as the Olympic games and the World Cup, waving national flags and singing national anthems. Yet these symbols of national identity were manufactured by ideologues to bolster support for their own particular conception of the state. The state is a geopolitical entity; the nation is a cultural or ethnic entity. The idea of the nation state implies that the two should coincide; it is a state ruled in the name of an ethnic majority. Despite the ubiquity of this idea today, it is neither inevitable nor natural.

Nationalism has its own ethical precepts, the most important of which is that people owe more duties to other members of the same nation than to members of other nations. This leads Americans to vote for politicians who promise to stop “American jobs” from being outsourced to China, and prompts Chinese leaders to erect import barriers. It also leads to cumbersome restrictions on freedom of movement, in the form of a convoluted system of citizenship, immigration authorities, passports, visas, and national sovereignty. Yet this apparatus is a very recent development. International travel in the nineteenth century was largely free of such encumbrances.

Nationalism gains its power from telling enticing stories, stories that appeal to our innate tendency towards groupishness, stories that give us a sense of belonging. How can we liberate ourselves from the grip of these powerful narratives? Not by disinventing them. It is very hard to disinvent something once it has been invented, whether it be a technology or a story.¹⁰ But just as we can render an invention obsolete by inventing a better technology, so we can render stories less attractive by telling better stories. So, what will the better stories be like in this case? For one thing they will be more factually accurate, but that is not enough by itself. They will also need to be emotionally satisfying.

We’ll come back to nationalism in chapter eight. The rest of this chapter focuses on the political and economic obstacles to competitive governance.

* * *

The biggest political obstacles standing in the way of competitive governance are intergovernmental organizations such as the United Nations and the OECD. These organizations are effectively cartels whose aim is to reduce competition between members. The result of this reduced competition is, as always, homogeneous products.

For example, the UN declaration on human rights is far more encompassing than it needs to be. In stating that everyone has the right to free primary education (article 26), it goes way beyond any reasonable conception of natural rights, and betrays a hidden agenda with a definite political flavor. Likewise, in asserting the universal right to social security (article 22) and to protection against unemployment (article 23), the UN elevates one particular view of the way society can be organized into a general obligation for all. Those who take a different view are, it would appear, not entitled to implement them. Libertarians, on this account, are not to be regarded merely as having different opinions, but as opposed to some basic human rights!

The UN declaration of human rights also enshrines nationalism and the nation-state as eternal ideals rather than as contingent products of history that might one day be improved upon. Article 15 stipulates that “everyone has the right to a nationality,” thereby betraying the oft-ignored truth that internationalism is

¹⁰ I owe this observation to Adrian Bowyer.

predicated on nationalism, that is, on the nation-state as the fundamental geopolitical entity, something that is still evident today in the very name of the United Nations.

The rise of nationalism in the nineteenth century was intimately linked with the rise of democracy, as those agitating for parliamentary representation increasingly portrayed themselves as “oppressed nations” rising up against the despotic rule of monarchs and emperors. It is perhaps not surprising then, that the UN declaration on human rights should also elevate democracy into a universal imperative, stipulating that governments must be chosen by means of “periodic and genuine elections which shall be by universal and equal suffrage and shall be held by secret vote or by equivalent free voting procedures” (article 21). The possibility that the “will of the people” could be expressed through other means, such as by voting with their feet, is not even considered. Indeed, it is implicitly ruled out *tout court*.

* * *

Another example of the tendency of intergovernmental organizations to reduce global diversity is the implementation of so-called “tax harmonization” policies by the EU and the OECD. These policies are aimed at making taxes identical or at least very similar across all member countries. All members of the EU, for example, must have a value added tax of at least 15%. This is essentially a form of price-fixing, which is classic cartel behavior. Although the OECD pays lip-service to competition in general, it draws the line when it comes to taxation, where all of a sudden competition becomes “harmful,” as the title of a major OECD report published in 2007 stated in no uncertain terms.

The report begins by noting that not *all* tax competition is harmful. It recognizes that “there are no particular reasons why any two countries should have the same level and structure of taxation” and that differences in tax levels “are essentially political decisions for national governments” (para 26, p.14). It goes on to note that special tax incentives or tax regimes may be necessary in some countries to offset non-tax disadvantages such as poor geographical location, or a lack of natural resources. Similarly, within countries, certain peripheral regions may need more attractive tax regimes or tax incentives to boost development. Nevertheless, the report draws a line between these incentives and deliberate attempts to redirect capital and financial flows from other countries by aggressively lowering taxes. This, it seems, is tantamount to “poaching” the tax base that “rightly” belongs to the other country. It is “practices of this sort” that the OECD labels “harmful tax competition” because they are “tailored to attract investment or savings originating elsewhere.”

The distinction is murky, to say the least, which is of course a virtue when interests are at stake rather than principles. The rhetoric of the OECD report is pretty transparent anyway. To allege that harmful tax practices “undermine the fairness, neutrality and broad social acceptance of tax systems generally” simply begs the question as to whether “tax systems generally” really are all that fair, neutral, or socially acceptable. To claim that tax competition “undermines

taxpayer confidence in the integrity of tax systems” is to assume that such integrity already exists, and that all good taxpayers should have a quasi-religious faith in it.

It is hardly surprising that high-tax nations dislike tax competition. Working through intergovernmental organizations like the OECD, the European Union, and the United Nations, these governments are vigorously promoting various tax harmonization schemes designed to prevent tax-payers from taking advantage of lower tax regimes in other countries. For example, the OECD has identified more than forty so-called tax havens, and threatens these with various punitive measures if they do not agree to bring their practices into line with the OECD’s own rules. Likewise, in 2011, the European Union proposed a Common Consolidated Corporate Tax Base (CCCTB), a common system for calculating the tax base of businesses operating in the EU. In a similar vein, the United Nations has called for the creation of an international tax organization that would have the power to override the tax policy of sovereign nations.¹¹

The pressure brought to bear on Ireland to raise its corporate tax rate shows how heated the debate can get. Before the economic boom of the 1990s, the corporate tax rate was very high, reaching 50 per cent in 1984. The boom itself was partly fueled by the decision to slash tax rates, with corporate tax falling to just 12.5%. Needless to say, Ireland has taken a lot of heat from its European neighbors and from the US for its perceived efforts to lure corporations. In 2009, Ireland made President Obama’s list of tax havens, and the French government has consistently condemned the Irish corporation tax system, most particularly during the premiership of Lionel Jospin. In 2010, Germany and France even tried to make an increase in the corporate tax rate a condition for granting Ireland a rescue package to help it deal with the financial crisis, but the then finance minister Brian Lenihan refused, saying the corporate tax regime was an “absolute red line.”

* * *

Further evidence of the cartel-like structure of most intergovernmental organizations lies in the absence of any remedy for those who object to the government monopoly of certain services. Governments provide their citizens with a bundle of services, including identity verification (passports), protection services (police), arbitration services (civil courts), and so on. There is no reason why these services have to be bundled together, but in practice they usually are.

When a company bundles unrelated services together, this can trigger competition regulators and private litigants to file antitrust suits against them. In 1998, for example, the United States Department of Justice (DOJ) filed a set of civil actions against Microsoft alleging that the software giant had abused its monopoly power on Intel-based personal computers by bundling its flagship Internet Explorer (IE) web browser software with its Microsoft Windows

¹¹ “Tax competition and fiscal reform: rewarding pro-growth tax policy,” by Dan Mitchell (Heritage Foundation).

operating system. The DOJ claimed that this restricted the market for competing web browsers, since these took a long time to download at the prevailing bandwidths, or had to be purchased at a store.

Unfortunately, no such remedy is available when governments do the bundling. Unlike companies, governments are sovereign – that is, there is no authority above them. Intergovernmental organizations like the UN and the World Bank only have authority over sovereign states when granted such authority by those states. The authority can be withdrawn at any time, and so really remains vested in the sovereign. The World Trade Organization (WTO) attempts to liberalize international trade, but is fairly toothless. It would be fun if someone asked the WTO to force a national government to break up the bundle of services it provides and allow third parties to provide them, but I doubt if they would get very far.

* * *

Competitive governance would be particularly effective at generating political progress if new entrants could challenge incumbents.¹² Just as startups are a major contributor to innovation in business, the regular formation of “start-up states” would accelerate the discovery of better forms of political organization. A large but fixed population of competing states would permit some progress, but it would be much faster if new states could be formed more easily.

The link between high rates of entry in an industry and innovation is widely acknowledged. All organizations are subject to life-cycle effects, and companies are no exception. A combination of sheer inertia, and a rational desire to avoid the high cost of failed reform, means that older firms are less able to remake their organizational structure or come up with new products. Most product innovation and organizational change comes from the establishment of new organizations rather than the restructuring of existing ones. It follows that high barriers to entry tend to reduce innovation at an industry level.

This points to another obstacle faced by competitive governance. As Patri Friedman, grandson of the economist Milton Friedman, puts it; “government is an industry with a really high barrier to entry; you basically need to win an election or a revolution to try a new one.”¹³ The only other option would be to start a new country, a “start-up state,” but that’s not particularly easy either.

The main problem is real estate. You can’t start a new polity without territory, and every bit of the earth is now claimed by at least one sovereign power. Hence new states can only be formed if some part of an existing state unilaterally breaks away from its parent country (secession), or if the parent country grants

¹² Patri Friedman and Brad Taylor, “Entry Barriers and Innovation in the Market for Governance,” July 2011, http://seasteading.wpengine.netdna-cdn.com/files/friedman_taylor_barriers_to_entry.pdf Accessed 23 October 2012.

¹³ Patri Friedman, cited in <http://www.wired.com/science/planetearth/news/2008/05/seasteading>

independence to some part of its territory. We'll look at these options in chapter six, but in the rest of this chapter I'll focus on a far more radical proposal – to create new real estate by building cities in the sea.

The movie *Waterworld* (1995) envisions a future in which people live in floating settlements, artificial islands made of scrap, and old oil tankers. Patri Friedman thinks something similar could provide a cheap way to start a new state. He thinks that new floating cities will give people the opportunity to test new ideas about how to live together. In keeping with the idea of competitive governance, Friedman argues that the most successful of these new settlements will become thriving new societies, inspiring change around the world. Within a few decades, he predicts, millions of people will have colonized the oceans, living with innovative governments of their choosing. Friedman terms this ambitious project “seasteading.”

By proposing new settlements out at sea, beyond the territorial waters that extend at most twelve nautical miles (22 km; 14 mi) from the coastline of existing states, Friedman trusts they will be protected by the 1982 United Nations Convention on Law of the Sea. This stipulates that the high seas are free to all nations, but belong to none of them, an idea that can be traced back to the seventeenth century Dutch legal philosopher Hugo Grotius. Friedman is by no means the first to take advantage of this principle; in 1967 a pirate radio broadcaster by the name of Paddy Roy Bates, commandeered a disused naval defense platform off the coast of England and later declared it to be an independent sovereign state. The Principality of Sealand, as it became known, has its own constitution, flag, national anthem, currency, and passports, but it is not officially recognized by any established sovereign state. After an English court ruled in 1968 that it did not have jurisdiction over Sealand as it lay outside British territorial waters, Bates cleverly claimed that this constituted *de facto* recognition by the United Kingdom, but the question is moot. Bates died in 2012 at the age of 91, but Sealand continues to be managed by the Bates family who regard themselves as its hereditary royal rulers.

Nevertheless, the United Nations Convention on the Law of the Sea, which has been in force since 1994, which states that “artificial islands, installations and structures do not possess the status of islands,” and therefore “have no territorial sea of their own.” In the opinion of the expert on sea law and sovereignty John Gibson, “because Sealand was man-made there was little chance that it would be recognised as a nation.”¹⁴

The floating cities envisioned by Friedman would be far grander than Sealand, with populations of several thousand, but they would not necessarily be large unified structures. Friedman thinks a modular design would be better for several reasons. Firstly, a modular structure lends itself to an incremental approach where one module at a time is built. More importantly, it would lower the cost of emigrating; if the seastead you were living in started implementing policies you

¹⁴ Cited in http://news.bbc.co.uk/2/hi/uk_news/778267.stm Accessed 27 Oct 2012.

didn't like, you could simply motor to a new one. In other words, you can migrate without having to leave your house; "if the government announces an unpopular policy on Monday, by Tuesday there may be nothing left of the city but the capital building, overlooking a serene seascape of empty waves," writes Friedman; "a modular city will give its residents an unprecedented degree of control over their political affiliation."¹⁵

Another advantage of modularity is that it doesn't require a massive initial investment. Seasteading could start small, with tiny family-sized platforms called "coaststeads" near the mainland serving as a test bed before full-fledged community-size seasteads are ready to launch in international waters. Friedman reckons these starter homes would be commensurate with housing costs on land, with some estimates in the range of \$258 per square foot, which at the time of writing is a lot cheaper than many family homes in the San Francisco Bay area.¹⁶

Friedman's ideas gained some support in 2008, when PayPal founder Peter Thiel donated \$500,000 to enable him to start The Seasteading Institute, a non-profit dedicated to creating experimental ocean communities. Among other things, the Institute fosters engineering research to investigate feasible designs for seasteading communities, and sponsors a prize for the establishment of the first independent seasteading community. The Poseidon Award will be awarded to the first seastead which has at least 50 full-time residents, is financially self-sufficient, and has de-facto political autonomy.

* * *

One problem that seasteads might face is military interference from existing states. Even a tiny force can be sufficient to put paid to a nascent polity in the high seas, as is clear from the curious story of the Republic of Minerva.

The brainchild of Nevada businessman Michael Oliver, the Republic of Minerva was to be a libertarian-inspired city-state built from reclaimed land in the southern Pacific Ocean. In 1971, barges loaded with sand from Australia arrived at the Minerva Reefs, about 400 miles south of Fiji and 260 miles west of Tonga, and raised the reef level above the water. The following year, the Republic of Minerva issued a declaration of independence and elected its first Provisional President.

What happened next is not entirely clear. According to some reports, the Tongan government sent a naval gunboat to reassert its own claims to the reef. Other reports claim the vessel was not a gunboat but a rowboat crewed by King Taufa'ahau Tupou IV and a brass band. In any case, on 21 June 1972, the

¹⁵ Patri Friedman, Wayne Gramlich, and Andrew House, "Seasteading: A Practical Guide to Homesteading the High Seas, Work in Progress, 2002-2008, <http://www.seasteading.org/book/seasteading-book-beta/> Accessed on 24 October 2012.

¹⁶ vv <http://reason.com/archives/2009/06/08/20000-nations-above-the-sea/2>

Minervan flag was hauled down, and the atoll was later formally annexed to the Kingdom of Tonga.

Friedman worries that something similar might happen to the first seasteads. To forestall this possibility, he suggests that seasteads might fly a “flag of convenience” from a country that sells them, like Panama, to provide them with protection from national navies. A hundred years ago, commercial vessels used to fly the flags of their nation. They were little pieces of their home country cast adrift on the high seas. If things went wrong, the sailors were protected by their government; if they *did* wrong, they could be punished. But in the 1920s, things began to change. Panama allowed American vessels to fly the Panamanian flag, for a fee, which allowed cunning American shipowners to transport alcohol and avoid Prohibition laws. Liberia and other countries followed suit. Today over 60 percent of commercial vessels fly such flags of convenience, with Panama, Liberia, and the Marshall Islands flags accounting for almost 40 per cent of the entire world fleet in terms of deadweight tonnage.

By taking advantage of this system, seasteads might reduce the risk of being attacked by another state. “If you're not flying a flag ... any country can do whatever they want to you,” Friedman explains. But a country will think twice before attacking a vessel flying another nation’s flag, for this could provoke serious diplomatic and even military consequences.

Friedman is less worried by pirates than by US intervention....this threat would place some restrictions on the business model of seasteads (eg. they could not specialize in refining cocaine, or providing resorts for drug tourism)... Drug policy is also another example of the way that the cartel of nations attempts to enforce uniformity and thereby reduce competition... It is also a great excuse for expanding state power in a whole range of domains (eg. it is used to justify attacks on banking secrecy on grounds of attacking money laundering; and to justify aggressive civil asset forfeiture programs – i.e. government confiscates property when it considers it to be drug related. The government also does not need to prove guilt; it just seizes it. Sometimes the police just keep it; usually, they sell it and keep the money).

* * *

Unsurprisingly, given the threat that flags of convenience pose to the cartel of nations, there has been substantial opposition to the practice. In 1958, the Geneva Convention on the High Seas insisted that there must be a “genuine link” between a ship's owners and its flag state, and this principle was restated two decades later in the United Nations Convention on the Law of the Sea. Like the tax harmonization policies we looked at earlier in this chapter, these treaties are aimed at reducing competition and at raising barriers to entry into the governance market.

Existing countries further restrict access to the cartel by means of a complex system of “state recognition.” According to the constitutive theory of state

creation, which was prevailed throughout the nineteenth-century, a state exists exclusively via recognition by other states. This of course serves the interests of existing states wonderfully, as it heavily loads the dice in favor of the status quo, and it was largely in reaction to the conservative nature of the constitutive theory that the alternative, declaratory theory was developed in the twentieth century. In the declaratory theory, an entity becomes a state as soon as it meets the minimal criteria for statehood; recognition by other states is not necessary, and merely acknowledges an existing reality. The minimal criteria for statehood are a defined territory, a permanent population, a government and a capacity to enter into relations with other states.

Examples of states with limited recognition are Taiwan (the Republic of China), which the People's Republic of China purports to control and vice versa; Palestine, which seeks control of territory inside the State of Israel; the Republic of Somaliland, which declared independence from Somalia in 1991 as the successor to British Somaliland; the Republic of Abkhazia, which declared independence from Georgia in 1999; and the Sahrawi Arab Democratic Republic, which claims control of the Western Sahara in opposition to a claim by Morocco. These should not be confused with microstates, which have small land area but which enjoy full recognition by the international community. Examples of microstates are Vatican City, Monaco, San Marino, Liechtenstein, Malta, Andorra, and the Federated States of Micronesia...

* * *

One of the great geopolitical dramas of the twenty-first century will be the tension between the centrifugal forces that lead to devolution, secession and Balkanization on the one hand, and the centripetal forces leading to greater centralization of power and the consolidation of supranational political entities like the European Union....

H G Wells book *The Shape of Things to Come* (1933) foresaw the establishment of a world government, but it was not the first novel to do so. A century earlier, in 1834, Felix Bodin envisioned a Universal Congress in *Le roman de l'avenir* (*The Novel of the Future*).

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...BRIEF SUMMARY OF CHAPTER...

With so many obstacles that hinder progress towards competitive governance, are we stuck with a world in which most people are disappointed? Is a mobile, diverse world in which everyone can get what they want yet another utopian fantasy, as impractical and impossible to achieve as communism?

In the next chapter, I argue that despite the many obstacles, there is a realistic, plausible and practical route from the current world order to the one I envisage in this book. Despite everything, there are reasons to be optimistic.

Chapter Six: Green Shoots

The obstacles standing in the way of competitive governance are considerable. At the level of individual countries, democratic systems favor the status quo. At the global level, nation states act in many respects like a cartel, restricting competition by means of intergovernmental organizations.

There are nevertheless reasons to be optimistic. The first has to do with the natural tendency of cartels to fracture. Game theory suggests that cartels are inherently unstable, as each member of a cartel has an incentive to cheat. Although members of the Organization of the Petroleum Exporting Countries (OPEC), for example, agree to limit their oil production to certain quotas, these are regularly flouted, since each member can make more profit by producing more oil than their quota permits. Empirical studies have found that the business cartels that were discovered in the twentieth century rarely lasted more than ten years.

It is hard to know how long intergovernmental cartels like the UN and the OECD will be able to keep their members in line, but sooner or later some countries will begin to break ranks. There are already some cracks in the system. Tax havens and special economic zones, for example, flout the taboo on tax competition by charging little or no tax.

In this chapter I will examine some of these fissures in the contemporary world order. The interesting thing about these developments is that none of them began with the aim of paving the way for a global system of competitive governance. Tax havens were not created for any ideological reason, but merely to enable companies and wealthy individuals to protect their assets from the grasping hand of government. Likewise, special economic zones were created to facilitate the economic development of the host nation, not to weaken the grip of the nation state. Nevertheless, these developments may prove to be the first steps in the journey that leads ultimately to the new world order I envision in this book.

In other words, if a global system of competitive governance ever develops, it will probably do so not as the result of a deliberate plan, such as Marx envisioned for communism, but as the by-product of diverse projects with quite different aims and objectives. A good historical analogy would be China's economic transition from a communist system to capitalism, for as Ronald Coase and Nin Wang point out, the extraordinary thing about this transition is that it was not programmed, and the final result was entirely unexpected. It is a striking example of what the economist Friedrich Hayek called "the unintended

consequences of human action.” [Hayek, 1967, *Studies in Philosophy, Politics, and Economics*, Chicago: University of Chicago Press, chapter 6.]

* * *

In December 1978, the leaders of the Chinese Communist Party assembled in Beijing for what would turn out to be an historic meeting. The Third Plenum of the Eleventh Central Committee is now widely regarded as the starting point of the process that transformed China from a backward agrarian economy into the global powerhouse that it is today. But according to Coase and Wang, the Chinese leaders did not even contemplate a market economy at the time. They simply wanted to foster economic growth, and were prepared to try anything that would help them achieve this goal.

It was this new sense of pragmatism and open-mindedness that allowed Deng Xiaoping to oversee the creation of a number of Special Economic Zones, starting with Shenzhen in 1980. At that time, Shenzhen was a small fishing town known mainly as a point of departure for illegal emigrants fleeing the mainland for Hong Kong, a short boat ride away. When local officials had asked Deng for more soldiers in 1977 to stem the tide of emigrants, he replied that there was nothing the army could do; the only way to stop people leaving, he realized, was to make Shenzhen more like Hong Kong. Three years later, Shenzhen was formally nominated as the first Special Economic Zone in China.

Over the course of the next three decades, Shenzhen went from being a poor town of less than 30,000 people to the fastest growing city in China, with more than 14 million inhabitants. Other Special Economic Zones followed in its wake, and their influence spread inwards from the periphery to the core of China’s economy. Unlike export processing zones and industrial parks zones in other parts of the world, the Special Economic Zones became fully-equipped, self-sustaining economic entities, complete with a wide range of educational, commercial, legal and governmental services. Moreover, they were given a large degree of autonomy and were encouraged to experiment with markets and learn from capitalism.

However, as Coase and Wang emphasize, the Special Economic Zones “were not meant to be the stepping stones for capitalism to conquer China; their ultimate goal was to serve socialism.” [p.62] Nevertheless, as one Chinese saying goes, it is hard to keep a window open to let fresh air in but keep the flies out. The success of Shenzhen and the other cities that followed in its wake was a crucial factor in the gradual transformation of China from a closed socialist economy to a dynamic market system. Although the Communist Party continues to spout the rhetoric of socialism, China today is a capitalist country in all but name.

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If the world moves towards a global system of competitive governance, it will probably do so in a way that resembles China’s economic transition from a communist system to capitalism – that is, as the unintended consequence of local

experiments like Shenzhen. And just as the Special Economic Zones were transgressive ventures that flouted the rules prevailing in the rest of China, the seeds that bring forth the first green shoots of competitive governance will likely be rogue elements, bitterly resented by the defenders of the status quo.

Tax havens are well placed to play such a role. They are local experiments, typically located on small islands, and are often the target of fierce criticism. We have already seen, in chapter five, how intergovernmental organizations like the EU and the OECD have implemented tax harmonization policies aimed at making taxes identical or at least very similar across all member countries. The OECD has also identified more than forty tax havens, and is trying to force them to bring their practices into line with the OECD's own rules.

As with the notion of "harmful tax competition" more generally, the term "tax haven" is loaded, and there is no consensus as to what it means. One approach, which I will adopt here, defines tax havens as jurisdictions that deliberately create legislation to ease transactions undertaken by non-residents. Tax havens usually offer considerable, legally protected secrecy to ensure that financial transactions cannot be traced to those undertaking them. Such transactions are termed "offshore," meaning that their legal location is decoupled from their real location, with the result that the tax liability of the transaction from the place where it actually occurred.

Like all jurisdictions, tax havens use legislation and tax policy to attract various types of international clientele, and as we saw in the last chapter it is widely agreed that that special tax incentives or tax regimes may be necessary in some countries to spur economic growth. However, while these incentives are generally accepted if they offset non-tax disadvantages such as poor geographical location, or a lack of natural resources, they are condemned if they simply redirect capital and financial flows. Tax havens not only specialize in the latter, but make it the centerpiece of their developmental strategy. Thus while the United States applies a zero tax rate on certain categories of income, it is not generally considered a tax haven because this is not the main plank of its economic policy. The distinction between tax havens and other preferential tax regimes is therefore somewhat arbitrary, and has been described by the legal scholar Charles Irish as a "matter of degree more than anything else."

Large countries like the US can follow a wide variety of paths to economic growth, but for some very small countries tax competition may be the only viable option. Tax havens thus tend to be among the smallest independent jurisdictions in the world, and many of them are small islands, such as Jersey, Bermuda, and the Cayman Islands. Despite their small size, however, tax havens play a prominent role in the global financial system. Estimates suggest that since the early 1980s about half of all international banking assets and liabilities have been routed through offshore financial centers (OFCs), and about a third of all multinational corporations' foreign direct investment goes through tax havens.¹⁷

¹⁷ <http://www.historyandpolicy.org/papers/policy-paper-92.html>

The rise of tax havens illustrates the tensions that threaten the cartel of nations. As we saw in the previous chapter, intergovernmental organizations like the EU and the OECD attempt to reduce global tax competition by means of tax harmonization policies. But these efforts are hobbled because some member countries, including the UK, Switzerland, Ireland, and the Benelux countries, are themselves considered tax havens. The UK often resists international efforts to combat tax havens, since some of the most important havens are UK dependencies, while Switzerland jealously guards its banking secrecy laws. Such disunity on a fundamental matter like taxation offers hope that the pressure to attract financial capital may introduce further cracks in the international system and weaken intergovernmental organizations. This might in turn make it easier to create new jurisdictions. Tax havens might therefore prove to be among the first steps in the journey that leads ultimately to the new world order I envision in this book.

* * *

Tax havens may be small, but they are still independent jurisdictions, enjoying full sovereignty. Other local experiments that pave the way for competitive governance may be more like Shenzhen – special economic zones operating within the territory of a sovereign state, but under different rules. For example, the Dubai International Financial Center (DIFC) is a financial free zone in which a British judge administers British common law in all commercial cases, while United Arab Emirates sharia law continues to apply to family law issues.

In choosing to adopt British common law, the DIFC signaled its intention to become a global financial hub to rival London, New York and Hong Kong, which are also based on common law. And the strategy worked; by 2008, just four years after its official launch, the DIFC had attracted over 750 firms, and private sector investors had invested over 18 billion dollars in infrastructure.

For a Muslim country to allow British common law to operate in part of its territory may appear surprising. And yet, as Michael Strong and Robert Himber have argued, there is a long tradition in Islam of allowing substantial legal autonomy to different communities.¹⁸ For hundreds of years, communities of Jews and Christians living within Muslim countries were permitted to adhere to their own laws, and Islamic legal practice became adept at managing the boundaries between sharia law and these other competing and overlapping legal systems. Islam's traditional respect for notions of contract and negotiation, may mean that the Muslim world is more open to experimenting with novel legal structures than other regions.

The success of the DIFC in attracting foreign direct investment may tempt other countries to copy its recipe of importing a foreign legal system within a section of national territory. This would be another crack in the current world order,

¹⁸ Michael Strong and Robert Himber, "The legal autonomy of the Dubai International Financial Centre: a scalable strategy for global free-market reforms," *Economic Affairs*, Volume 29.2 (June 2009), pp.36-41.

based as it is on the idea of a single legal regime for each nation state. If this crack widens, and different legal systems proliferate within and perhaps across national boundaries, existing norms of national sovereignty could be increasingly eroded. As in the case of tax havens, special economic zones and financial centers could prove to be the unintentional first steps towards a global system of competitive governance.

* * *

More ambitious even than economic zones like DIFC are the plans to create entire free cities in various parts of the world. These initiatives build on the concept of a special economic zone by increasing its size and expanding the scope of its reforms. Covering hundreds of square kilometers rather than just one or two, free cities must be large enough to accommodate millions of workers and residents. And the reforms to be implemented by free cities need not be limited to lower taxes or alternative legal systems, but can extend to more permissive immigration policies and even autonomous governments.

The idea was inspired by the amazing success of post-colonial Hong Kong. In a 2007 article in *The Weekly Standard*, Ken Hagerty and Theodore Roosevelt Malloch noted that thanks to the agreement that China had signed with the UK in 1984, Hong Kong had remained a free city inside China after returning to Chinese sovereignty in 1997, with its own laws, democratic legislature, and independent judiciary. It had kept its free market economy, its low rate tax system, and its separate, convertible currency, an arrangement the Chinese referred to as “One Country, Two Systems.”

Hagerty and Malloch proposed that the United States should create an ambitious program to build treaty-based free cities along the lines of Hong Kong in developing countries around the world. The US could, they suggested, negotiate fifty-year bilateral treaties with the host countries, authorizing the purchase of undeveloped plots the size of Hong Kong, where a different set of rules could be implemented that would protect property rights and boost economic freedom. Like Hong Kong, these tiny places would become safe havens for investors and entrepreneurs. They would allow citizens to raise capital, attract the skills they need from abroad, and create thousands of new jobs.

The joint venture would only have to build the free cities’ public infrastructure, and that could be financed by resale of city land, city taxes, and bonds. The global private sector would gladly develop everything else because investors would be able to reap the rewards of their own enterprise. And the host country’s ruling elite would learn quickly, as China’s did, that they could earn much more by leaving their free city alone than they would ever be able to pocket from squeezing it or otherwise interfering.

Hagerty and Malloch were not the only ones to be intrigued by the Chinese idea of “One Country, Two Systems.” In 2002, several years before their article in *The Weekly Standard*, an American advisor and former Regan speechwriter called Mark Klugman had proposed a similar idea to Pofirio Lobo, then President of the

Honduran National Congress. Klugman suggested that Honduras might follow the Chinese model of allowing a few regions to have different legal, economic and financial arrangements. These LEAP Zones, as Klugman called them (to emphasize the need for reform in the full range of legal, economic, administrative, and political systems), would provide enclaves where industry could flourish away from the influence of the drug trafficking and other corruption that plagued the rest of Honduras.

Like most nations, Klugman argued, Honduras was too large to tackle corruption and crime everywhere simultaneously. LEAP Zones would offer the right scale for dramatic change. Lobo liked the idea, but did not have the political clout to pursue it at the time, so told Klugman, “ask me again when I am president.”

Seven years later, in November 2009, Lobo was elected President of Honduras and the following January, within days of taking office, he met with Klugman to discuss the idea of creating LEAP Zones. Together with Lobo’s chief of staff, a visionary young lawyer called Octavio Sanchez, and Ebal Diaz, a legal advisor, Klugman started work on designing the Constitutional Statute that would define the Special Development Regions, as they soon came to be known.¹⁹

In February of 2011, the Honduran Congress passed a constitutional amendment permitting the creation of Special Development Regions (RED in Spanish, an acronym of *Regiones Especiales de Desarrollo*). Later that year, in July, the Congress passed a constitutional statute defining their governance structure, and in September 2012 the government signed a memorandum of understanding with a group of international investors to kick start the initial phase of construction. Everything was going according to plan.

And then, in one fell swoop, the project was killed. On 18 October a plenary hearing of the Supreme Court of Justice declared the legislation permitting the Special Development Regions to be unconstitutional. In particular, the Court held that the legislation violated various articles in the constitution referring to matters of sovereignty, the system of government, and the integrity of national territory.

Octavio Sanchez was nonplussed. Speaking to me in his office in the presidential palace a few weeks after, he denied there was any sound legal basis for the Court’s decision. It was a purely political act, he claimed, motivated by self-interest on the part of the judges, who saw the free cities as a threat to the power of the legal profession.

¹⁹ Around the same time, an influential economist called Paul Romer was also becoming interested in the idea of creating free cities. In July 2009 Romer gave a talk at TEDGlobal, a conference for technology enthusiasts in Oxford, in which he suggested that free cities could provide an alternative route to economic development for poor countries. Although Romer spoke of “charter cities” rather than free cities, the idea was essentially the same as that proposed two years previously by Hagerty and Malloch.

Whether or not this was the primary reason for the Court's decision, Honduran lawyers would indeed have seen their sphere of influence diminish if the Special Development Regions had been allowed to proceed, for these regions would have been able to operate under different legal systems. This in fact was a vital aspect of their design. Although a lawyer himself, Sanchez had become convinced that the antiquated Honduran legal system was one of the principle obstacles hindering economic development in his country. The LEAP Zones envisaged by Klugman had caught his imagination in part because they linked economic reform to legal and administrative innovation. In particular, Klugman suggested that the only way for a developing country like Honduras to escape the tangled web of bad rules and corrupt institutions that held it back was to imitate China. Rather than attempting wholesale, country-wide reform, Honduras could begin by permitting experiments in small regions where failure would have a minimal effect on the rest of the economy.

The legislation passed by the National Congress had stipulated that Honduran criminal law would still apply in the Special Development Regions, but in every other branch of law the Regions would be free to innovate. They would not, however, need to start from scratch. Klugman proposed that they could simply outsource the administration of justice to a third party by adopting, say, British common law as the basis for all commercial transactions, much as the Dubai International Financial Center had done. This would create a more favorable environment for direct foreign investment, since multinational companies are already familiar with this legal framework.

But these suggestions offended the national pride of certain sections of Honduran society and inflamed patriotic passions. Ironically, given that the rhetoric of nationalism tends to serve the interests of the ruling elites, some of the strongest opposition to the Special Development Regions came from the least privileged social sectors in Honduran society – that is, from those who stood to gain the most from their creation, and who benefited least from the status quo. The Garifuna community, for example, one of the poorest and most marginalized groups in Honduras, played a key part in organizing popular opposition to the project. They found it easy to portray certain key aspects, such as the possibility of outsourcing the administration of justice to another country, as a form of neocolonialism, and played on still bitter national memories of foreign intervention. The name of William Walker, for example, was often invoked. Walker was a US lawyer and adventurer who organized several private military expeditions in Central America in the nineteenth century with the intention of establishing English-speaking colonies. Nothing could be further from Walker's vision of creating new states to spread the institution of black slavery than the Special Development Regions, but the absence of any communication strategy on the part of the Honduran government meant that the populist rhetoric went unchecked. The politicians behind the project were accused of betraying their country and selling out to foreign interests.

Whether the plan to create Special Development Regions is dead in the water, or has merely suffered a temporary setback (as its proponents maintain), the events in Honduras in 2012 illustrate the difficulties likely to be faced by any

attempt to set up a free city in a democracy. It is probably not a coincidence that all the special economic zones and other embryonic free cities that have come into existence so far have been created by authoritarian regimes. When Chinese leaders nominated Shenzhen as the first Special Economic Zone, they did not have to worry about being re-elected or contend with any popular opposition. In Honduras, however, the Special Development Regions became a political football, and the project failed when protest groups were able to mobilize opposition by playing on nationalist sentiments and reviving memories of foreign intervention.

Similar worries about the loss sovereignty also provoked protests in nearby Panama around the same time after the National Assembly approved legislation allowing the sale of land in the duty-free zone of Colon. More than 2,000 companies operate in this lucrative free trade port area, at the Caribbean end of the Panama Canal, but when the government proposed selling some state-owned land in the area, hundreds of demonstrators burned tires and clashed with police. "We do not want the land to be sold because these are assets that belong to Colon," said the head of the Colonense Broad Movement, Felipe Cabezas.²⁰ Again, it is ironic that the protesters were largely poor workers, given that it is the ruling elites who benefit most from state assets. But the fact that nationalism is most passionately defended by those who least benefit from it will continue to make it particularly hard for free cities to get a foothold in democratic countries.

* * *

Although on a much smaller scale than free cities, private neighborhoods and gated communities offer similar possibilities for increasing the range of alternative social arrangements on offer to potential migrants. During the past few decades this kind of residential property has spread with astonishing rapidity over the United States, growing from around 1 per cent of American residential housing stock in 1970 to over 15 per cent in 2000.²¹

Take Hidden Hills for example. Located in Los Angeles County, California, this gated community is one of the oldest such developments in the US, and one of the richest. With a population of around 2000 and an area of just under 2 square miles (5 square kilometers), the community is home to many noted entertainment industry celebrities. Designed and developed in the 1950s, it became an incorporated city in 1961, which grants it considerable autonomy, with its own government and its own tax structure. Access is restricted to residents and their guests, and guarded gates prevent outsiders from entering. The population is 87 per cent white, compared to 74 per cent in the rest of California, and predominantly Catholic. Hidden Hills boasts a clubhouse with a swimming pool, and there is a rodeo arena and an extensive 42 mile network of bridle paths. Crime rates are extremely low.

²⁰ See <http://www.bbc.co.uk/news/world-latin-america-20012842>

²¹ Evan McKenzie, "The dynamics of privatopia: private residential governance in the USA," in *Private Cities: Global and Local Perspectives*, ed. Georg Glasze, Chris Webster, and Klaus Frantz (Abingdon: Routledge, 2006), pp.9-30.

Gated communities are not just for the rich and famous, however. The 2001 American Housing Survey showed significant concentrations of poor renters in these developments.²² Indeed, low-income renters are more likely to live in gated communities than affluent homeowners. Nor is the spread of privately managed and enclosed housing developments an exclusively American phenomenon. Private neighborhoods have been a prominent feature of cities in Latin America and South Africa since the 1980s, and have more recently spread to other parts of the world from Spain and Portugal to Israel, Lebanon, Russia, and China. Located just 12 kilometers from the center of Beijing, Purple Jade Villas is about half a square kilometer in size and comprises 400 luxury villas.²³ Some of these villas have private swimming pools, and for those that don't there are two community pools. There are four tennis courts, and two artificial lakes stocked with Wuchang fish and carp for angling. A continuous wall prevents outsiders from entering the community, and guards constantly patrol the grounds. The irony of such exclusive luxury in the middle of a country that still describes itself as communist is hard to miss.

The spread of private neighborhoods is driving a historically unprecedented transfer of governmental responsibilities back to private hands. These communities are governed by private associations with significant responsibilities and power, including the power to tax or "assess" residents to pay for common expenses (sometimes on pain of foreclosure and forced sale of the home), and to force them to obey rules by imposing fines. These rules may at times be more intrusive than the laws in most democratic states; they may include, for example, bans on the exercise of what would otherwise be regarded as free speech, such as displaying political or religious symbols.

These developments have been greeted with alarm by many commentators, who decry what they see as the privatization of public space. Yet from a historical perspective it is the open city that is the exception. Cities from ancient times through the Middle Ages and later often featured walls for protection from outsiders. The disappearance of such barriers in the past two hundred years, as governments took increasing responsibility for urban infrastructure, may well turn out to be an historical blip.

* * *

In this chapter, I've looked at some contemporary developments that might turn out to be the first steps in a journey towards to a world of competitive governance. From the perspective of politics as usual, none of these developments looks particularly promising, and some appear downright

²² Thomas W Sanchez, Robert E Lang, and Dawn M Dhavale, "Security versus status? A first look at the census' gated community data," *Journal of Planning Education and Research* 24:281-291, 2005.

²³ Guillaume Giroir, "The Purple Jade Villas (Beijing): a golden ghetto in red China," in *Private Cities: Global and Local Perspectives*, ed. Georg Glasze, Chris Webster, and Klaus Frantz (Abingdon: Routledge, 2006), pp.142-152.

pernicious. But from the perspective of the alternative political system that I envision in this book, they take on a very different appearance. They look like the first green shoots of a different world order.

Green shoots are all very well, but how might they develop into full grown plants? This is where my sketches of imaginary city-states come in. For each one of these future possibilities I have tried to imagine a plausible history linking it to the present day. As already noted, these are not predictions. They are merely an attempt to give a sense of how the future I envision in this book might come to pass.

Each of the developments in this chapter might generate a positive feedback loop that drives exponential change. For example, if the first free cities prosper, other countries might follow suit and set up their own versions. The more successful cities might then push for greater autonomy, and may even secede. The cracks in the cartel of nation states would then widen, and the current system may finally disintegrate altogether.

It may seem odd to put one's hopes for the future of humanity in things like tax havens, gated communities, and special economic zones. It certainly lacks the grandiose character of a revolutionary agenda or a plan for world government. But to my mind it is precisely the prosaic, peripheral quality of tax havens and economic zones that make them so appealing.

Once again, the recent China may provide an interesting lesson in this respect. It was precisely the lack of a clear vision of where China should be heading that allowed the post-Mao Chinese leaders to experiment with the economy in ways that would have been anathema under Mao. Compared to Mao's disastrous Cultural Revolution, the reforms implemented by Deng Xiaoping were prosaic and piecemeal, and their success was due not to heroic leaders but to ordinary people. As Coase and Wang point out, it was the peasants, the unemployed urban residents, and other marginalized actors in the socialist economy who turned out to be the vanguard of market transformation that swept China in the decades after Mao's death. On the basis of this observation, they go on to draw a larger conclusion:

The strongest elements of any society [...] are often not the best agents of change. It is not simply that the strongest actors are usually the beneficiaries of the status quo and are thus unwilling to change. Rather, the most powerful actors in society are often embedded cognitively in the existing system and can hardly think outside the box. Whatever they do is more likely to fine tune and perpetuate the system rather than transform it. It is the actors at the periphery who are able to bring to the stage different incentives, new skills, and fresh perspectives, critical ingredients for a revolution. [Coase & Wang, p.67]

It may also be "the actors at the periphery" who turn out to be lay the foundations for the new world order I envision in this book. Some of the things that politically correct people most sneer at today, such as tax havens, gated

communities, and special economic zones, may well turn out to be our best hope for the future.

Chapter Seven: The great migration

The biggest difference between the contemporary world order and the future world envisioned in this book is the scale of migration. The number of people living and working abroad in a world of competitive governance would dwarf the number of migrants today. At the time of writing, in 2012, about 200 million people are living outside their countries of birth.²⁴ That is almost double the number of first-generation migrants than in 1990, but it is still only 3 per cent of the world's population. What would that figure rise to if states started competing for migrants, instead of doing their best to keep them out? And what would be the effects of such an epic movement of people?

According to Gallup, 700 million people would like to move permanently to another country, but cannot do so because of the many barriers that restrict migration.²⁵ If these barriers were lifted, and all those people moved, the proportion of the world's population living outside their countries of birth would rise from 3 per cent to 13 per cent. In a world of competitive governance, the figure would be even higher, since there would be more reasons to migrate. The 700 million people who currently want to move wish to escape danger at home or seek better economic opportunities abroad. But in a world of competitive governance, people with adequate security and good jobs might nevertheless be tempted to move for political reasons.

In case this seems far-fetched, recall William Penn's charter for Pennsylvania. His legal guarantee of freedom of conscience attracted people from all over Europe. at a time when religious tolerance was at a premium. The people attracted by Penn's social start-up were political migrants, not economic ones. A similar point could be made about many Jews who move to Israel.

The distinction between political and economic motives for migration may not always be so neat. Many political choices, such as taxation levels and public expenditure, have economic consequences. More generally, a decision to migrate will involve trade-offs among a wide range of factors – not just economic and political ones, but geographic and cultural too. “Local governments have geographic as well as membership dimensions.” [Buchanan & Goetz, 1972, “Efficiency limits of fiscal mobility,” p.28].

²⁴ United Nations (2009) *Human Development Report 2009*. New York: United Nations Development Program.

²⁵ See

<http://www.gallup.com/poll/124028/700-million-worldwide-desire-migrate-permanently.aspx>

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What would happen if the barriers to global migration were lifted? Would it destabilize the world economy and lead to chaos? Economists think not. In fact, the most likely consequence would be a huge increase in worldwide income.

The main reason for this is the huge wage gap between rich countries and poor countries. In the year 2000, for example, the wage of a worker in Mexico was still 60 per cent less than that of a Mexican-born worker of similar education and experience working in America. Most of this wage gap is down to productivity differences arising from a whole range of factors, from infrastructure and technology to institutions and skills. A Mexican worker can earn more in the United States than in Mexico because he can produce more, due to the higher quality of US technology and institutions. According to one estimate, opening borders across the world could raise the average wage of migrants from developing countries by \$10,100 a year, or more than 100%.²⁶ If all the 700 million people who would currently like to move to another country were allowed to do so, global income would increase between 50 and 150 percent.

Current restrictions on migration are thus like leaving “trillion-dollar bills on the sidewalk,” in the arresting metaphor suggested by economist Michael Clemens.²⁷ This makes immigration constraints the greatest single class of distortions in the global economy. By comparison, the elimination of all remaining trade policy barriers and capital flow barriers would only lead to gains of a few percent of world GDP. Even a modest easing of immigration restrictions could be very rewarding. A 2005 study by the World Bank estimated that if migrants from poor countries swelled the rich-world labor force by just 3 per cent, the annual benefits would still be bigger than those from eliminating all remaining trade barriers.²⁸

Yet, as Clemens points out, “economists spend much more time studying the movement of goods and capital, and when they study migration at all, they focus on the effects of immigration on nonmigrants in destination countries.” It is high time this changed. The barriers to international migration deserve a research priority that is commensurate with their colossal economic effects. Globalization has demolished many of the barriers that used to choke international trade, and freed capital to flow around the world at lightning speed. It is time that labor too became globalized.

* * *

Migration can also benefit the economies that people leave behind. As we saw in chapter four, fear of “brain drain” may be overblown, since the possibility of

²⁶ “Open borders”, by John Kennan, NBER Working Paper #18307, August 2012.

²⁷ Michael Clemens, 2011, “Economics and Emigration: Trillion-Dollar Bills on the Sidewalk?” *Journal of Economic Perspectives*, 25(3): 83–106, p.1.

²⁸ World Bank. 2005. *Global Economic Prospects: Economic Implications of Remittances and Migration*. Washington.

emigration creates incentives for people in poor countries to invest in education, including among those who choose to stay.

Emigration also generates remittance flows back home. Remittances to developing countries have grown rapidly in the past decade, from below \$100 billion in 2002, to \$372 billion in 2011, and now amount to over three times the amount of foreign aid these countries receive.²⁹ The primary beneficiaries of these remittances are the migrants' families, but the long-term effect on economic growth is also considerable. Overseas Chinese provided huge amounts of capital to power China's takeoff in the 1980s, for example.

...while the informal links created by immigrant networks facilitate cross-country trade and investment... The surge in immigration since the 1980s has established large diasporas in high-income countries, which...

* * *

Despite all the economic benefits of migration, many people oppose lifting the barriers that prevent foreigners coming to work in their country. One reason for this opposition is fear that foreign workers will drive down wages. Yet this fear seems largely misplaced. Of the many studies to look at this question, very few find that immigration has a negative impact on native wages.³⁰ Indeed, immigration can encourage natives to take on more complex work. If an American finds it harder to get a job as a waitress because the restaurants are employing more Mexicans, she may start applying for office jobs. One study found that such "job upgrades" are responsible for a 0.6% increase in native wages for each doubling in immigrant labor-force share.³¹

A 2012 article in *The Economist* argued that millions of people could move from poor countries to rich ones without bidding down wages in the rich countries.³² A rapid burst of immigration might reduce wages for a short while, but if the flow of people was slow enough to allow investment to adjust, borders could open without any change in wages in either the origin or the destination economies.

The entry of women into the workforce provides an analogy: this expanded the labor supply and the scope for specialization without displacing the "native"

²⁹ Foreign aid dwarfed by funds sent home by immigrant workers - The Denver Post http://www.denverpost.com/dnc/ci_22129029/migrant-money-remittances-have-big-impact-back-home#ixzz2EiZYfSv3

³⁰ See "Immigration and the distribution of incomes", by Francine Blau and Lawrence Kahn, NBER Working Paper #18515, November 2012.

³¹ "Immigration, jobs and employment protection: evidence from Europe before and during the Great Recession", by Francesco D'Amuri and Giovanni Peri, NBER Working Paper #17139, June 2011.

³² See the following article from the Economist: <http://www.economist.com/news/finance-and-economics/21566629-liberalising-migration-could-deliver-huge-boost-global-output-border-follies>

male workforce. But even if the entry of women into the labor force did lower men's wages somewhat, nobody would argue that this is a good reason for limiting the rights of women to work. Likewise, nobody would argue that new companies should be forbidden on the grounds that they impose costs on existing firms. So why should things be any different when it comes to foreign workers?

Another reason why people oppose immigration is the fear that migrants will be a drain on the public purse. Yet this is only true if immigrants use social services more intensely than natives.³³ In reality, however, many migrants contribute more in tax than they receive in services, which more than compensates for those who are net recipients of public benefits. Besides, not all states in a world of competitive governance would even have welfare states. States without public services might be more open to immigrants than those with large public sectors.

Nor would those states with social services have to make these services available to immigrants. The Gulf states do not grant any such rights to the many guest workers that flock to work there, and there is no reason why future states might not implement similar policies, if they could do so and still attract enough immigrants. After all, the unequal way in which immigrants are treated in the Gulf states does not seem to stem the tide of foreign workers.

It would therefore appear that neither of the main economic reasons why people oppose immigration is well founded. Foreign workers do not drive down wages, and nor do they impose a significant burden on the public purse. If people still oppose immigration after these fears are dispensed with, it must be for other reasons beside the economic ones – most likely prejudice. The greatest wellspring of such prejudice is nationalism. This is the topic of the next chapter.

* * *

In addition to producing huge economic gains, the free movement people across the globe would also help mitigate the costs of climate change. According to the Fourth Assessment Report of the United Nations Intergovernmental Panel on Climate Change (IPCC), published in 2007, global mean temperature will be between 2 and 4 degrees centigrade higher than pre-industrial levels by 2100. This will cause sea levels to rise by perhaps half a meter, threatening hundreds of millions of people in coastal cities. Other regions will face different problems, from heat waves and droughts to hurricanes and typhoons.

These changes will be another factor driving global migration in the coming decades. In Bangladesh, for example, where most of the country is less than 6 meters above sea level, increased flooding could displace as many as 15 million people by midcentury. India isn't taking any chances. Already alarmed about illegal immigration, it is building over 2,100 miles worth of high-tech fencing

³³ "Economic impacts of immigration: a survey", by Sari Pekkala Kerr and William Kerr, Finnish Economic Papers, Spring 2011.

along its border with Bangladesh.³⁴ Such barriers will make it harder for the world to adapt to climate change. Removing them, however, could help to mitigate the costs of changing weather patterns by enabling economic activity to relocate to more hospitable bits of the planet.

To see how, consider the following simple model.³⁵ Suppose there is a heavily policed border running around the world at the 45th parallel. This runs through southern Europe, northern China, and the northern United States, with around 6 billion people living south of the line, and 1 billion to the north (see Figure 7.1). No migration is allowed across this line, but apart from that there are no restrictions on where people live and work. Since rising global temperatures are likely to improve agricultural production in northern climes, but reduce it near the equator, climate change will benefit the 1 billion people living above the border, as northern farmers sell more food to the increasingly impoverished masses to the south. Without this border, large numbers of people could move northward, and the resulting relocation of agricultural and industrial activity would ameliorate some of the effects of climate change.



Figure 7.1. The 45th parallel.

The model is simplistic, of course, but it suggests that migration policy can play a crucial role in addressing the impact of global warming. Migration restrictions increase the costs of climate change, and lead to even greater global inequality. Easing the barriers to free movement, by contrast, can significantly mitigate these costs. This suggests that a world of competitive governance could cope

³⁴ See http://www.eenews.net/special_reports/bangladesh/part_four

³⁵ Klaus Desmet and Esteban Rossi-Hansberg, "On the spatial impact of global warming," NBER Working paper #18546, November 2012.

with global warming far more successfully than the current system of nation states.

* * *

A third benefit of reducing barriers to migration would be the easing of demographic imbalances between rich countries and poor ones, especially the age gap. As the population continues to age in rich countries, the workforce will shrink and the demand for nursing care will increase. Immigrants can solve both of these problems, and the developing world can supply plenty of them, since about 31 percent of developing countries' population is below the age of 14, compared with 18 percent in high-income countries. Hundreds of millions of these people are unemployed or underemployed, and would willingly move to rich countries to find work.

The key statistic here is the dependency ratio, which is the number of nonworkers for every worker. This is crucial because nonworkers (children and old people) ultimately depend on workers for their support. Even pensions must be paid for current workers. For the high-income countries as a group, there is currently one worker for every nonworker. However, by 2025, 100 workers will be supporting 111 dependents, largely reflecting the increased number of the elderly (although the number of children will fall). The largest rise in the dependency ratio will be in Europe. At present, 100 European workers support 36 elderly people; by 2025 they will have to support 52.³⁶

In developing countries, by contrast, dependency ratios are expected to fall. The baby boom of the last two decades is now entering the labor force, while the number of elderly is only rising slowly. These trends will add nearly one billion workers to the world's labor force by 2025. If migration restrictions were lifted, the flow of workers from poor countries could help reduce dependency ratios in rich ones, and more wealthy pensioners might decide to retire to sunspots in poor countries.

However, for the impact on dependency ratios to be noticeable, increases in immigration would have to be very large. Even a 50 percent increase in the number of foreign workers would only reduce the dependency ratio in the host countries by about 3 percent. If migrants come with elderly relatives, the effect would be lower still. Huge movements of people will therefore be necessary if the world is to solve the demographic imbalances between rich and poor countries.

* * *

It costs money to move, and yet migration is not a luxury restricted to the rich. On the contrary, most migrants today are very poor. Every week, thousands of desperate people risk everything to move somewhere better. Often aided by

³⁶ The World Bank, "Global Economic Prospects: Economic Implications of Remittances and Migration," 2006.

unscrupulous human traffickers, who charge thousands of dollars for their services, they endure appalling conditions in rickety boats and claustrophobic shipping containers. Many of these people die horrible deaths, drowning when their small and overcrowded fishing boats sink in the Mediterranean sea, or brutally murdered for refusing to join drug cartels as they pass through Mexico.

Nevertheless, there are many more potential migrants who cannot afford the costs of moving. In a world of competitive governance, some states might choose to cover the relocation expenses for some immigrants. Such subsidies might be seen by some rich states as a worthwhile investment in the long-term. Subsidies could also be provided to immigrants by their countries of origin and by charitable third parties. Some villages in Nigeria pool costs to send bright students to European universities, which the students pay back with interest when they find work.³⁷ Websites such as LoyaltyMatch.com have provided a platform for transferring frequent-flier miles to third parties; perhaps schemes like this could be extended to include emigration sponsorship...

Subsidies could work the other way too. Where immigration disadvantages subsets of the population, Gordon Hanson argues that charging an entry fee to migrants or their employers could help pay for training or benefits for incumbents who lose out.³⁸

* * *

So far in this book, I have portrayed emigration as an alternative to democratic participation. But in reality, the two mechanisms need not be mutually exclusive. Elections may be theoretically unnecessary in a world of competitive governance, but this does not mean they will vanish altogether. Indeed, if voting with one's feet becomes the norm, this may actually make governments more attentive to the wishes of their citizens.

It may be helpful in this context to broaden our view of democratic participation to encompass more than just elections. In addition to voting every four or five years, citizens in a democracy can also attempt to influence government policy by writing letters to their elected representatives, donating money to political parties, canvassing for votes, and taking part in protest marches. All of these processes are examples of what the economist Albert Hirschman termed "the voice option," by contrast with emigration, which he called "the exit option:"

Hirschman defined the voice option as "any attempt at all to change, rather than to escape from, an objectionable state of affairs," and he emphasized that this could be both an alternative to exit, and a complement to it. When the exit option is unavailable, the voice option is the only way in which citizens can express their dissatisfaction with the state. But when citizens are free to emigrate, it does

³⁷ Mark Frazier, personal communication.

³⁸ "The economics and policy of illegal immigration in the United States", by Gordon Hanson, Migration Policy Institute, 2009.

not follow that they will stop using the voice option altogether. If citizens are sufficiently convinced that voice will be effective, they may well postpone exit for a while and try to change the policies they disagree with via the various methods of democratic participation available to them.

The presence of the exit alternative need not lead the “art of voice” to atrophy, therefore. In a world of competitive governance, citizens will not necessarily pack their belongings and move out the moment they feel let down by their government. The cost of moving, and the wish to stay and do something constructive, will ensure that democratic participation remains alive and well. As Hirschman noted, “once you have exited, you have lost the opportunity to use voice, but not vice versa,” so for some people exit will be the last resort after the exercise of voice has failed. Finally, there will always be those who neither emigrate nor protest, but simply suffer in silence, hoping that things will somehow get better anyway.

In fact, it is possible that the very existence of the exit option makes democratic participation more effective. The greater threat of emigration may, in other words, make states more responsive to the voice of the people. The more worried leaders are about losing valuable taxpayers, the more they are likely to listen to their complaints. The reason some companies are so desperate to solicit customer feedback is precisely to avoid losing them to their competitors. Perhaps governments would be equally attentive if they were faced with a similar threat.

Take the following exhortation, for example, from a well-known manufacturer of smoothies:

Open up. Talk to us. Give the banana phone a call, tell us about your day. Visit us on Facebook and let us know if you like our holiday photos. Tweet us about how much you like this smoothie. Make us laugh, make us cry, teach us new tricks. Open up and let the words fall out. Don’t be a clam.

This isn’t just an attempt to solicit feedback, of course. It is also an attempt to build customer loyalty and encourage word of mouth advertising. But by encouraging their customers to “make us cry” as well as laugh, and “teach us new tricks,” the manufacturers are clearly hoping to pre-empt exit. It is hard to imagine governments being quite so solicitous.

* * *

Modern technology makes migration a lot easier than it used to be. A century ago an Irish emigrant might pay a small fortune to board a ship, spend several weeks sailing to America, and not see or speak to his friends or family ever again. Today, he can book a cheap flight that gets him to New York in a few hours and text his mother the moment he arrives.

It is also much easier today for migrants to find out about their destination. When the hopeful settlers departed London for the Principality of Poyais in

Central America in September 1822, they expected to find a hospitable port with a well-developed infrastructure, gold and silver mines, and large amounts of fertile soil. This, after all, was what they had been promised by Gregor MacGregor, a Scottish soldier and adventurer who had arrived in London in 1820 brimming with news of the new country. MacGregor had even published a 350-page guidebook to Poyais which described the land in glowing terms. Intrigued by the promise of riches, seventy people chartered a ship to take them to the capital, Saint Joseph.

What they found when they arrived was virgin jungle, some natives, and a couple of American hermits. Saint Joseph consisted of a few crumbling remains of a former settlement that had been abandoned the previous century. The settlers were decimated by tropical diseases, and one poor soul, having used his life savings to gain passage, committed suicide.

It is doubtful whether MacGregor would have been able to pull off a stunt like this today. The web makes it very easy to find out about a place before deciding to go there. In a world of competitive governance, polities might advertise for immigrants on the web, and price comparison websites might enable them to pick and choose their destinations in the way people currently choose their car insurance. Potential migrants could compare public services and taxes in a wide range of destinations, and make their minds up accordingly.

All of these technological developments mean that the stage is set for the twenty first century to witness greatest migration in history. The greatest obstacle is no longer technological but ideological. If the great gains from migration are not in fact realized, it will be due to the countervailing force of nationalism. This is the subject of the next chapter.

Chapter Eight: The end of nationalism

If immigration is the greatest of all the forces driving the world towards a system of competitive governance, the strongest countervailing force is nationalism. Nationalism stands in the way of the most important requirements for competitive governance – freedom of movement, territorial reorganization, and what I will call a “prosaic” attitude to citizenship. In this final chapter I’ll try to get at the psychological roots of this strange ideology, and ask what the prospects are for its demise.

Nationalism is a form of loyalty in which the object of allegiance is an imaginary community that is supposedly bound together by a common language, culture, or ethnicity. Before the eighteenth century, people were generally loyal to a city or to a particular leader. The newly emerging political elites of nineteenth century Europe constructed the idea of national identity to build legitimacy for their new regimes, manipulating cultural symbols to create a powerful sense of belonging.

The state is a geopolitical entity; the nation is a cultural or ethnic entity. The idea of the nation state implies that the two should coincide, but there is nothing natural or inevitable about this juxtaposition. It is, rather, a contingent cultural artifact with a relatively short history. Sovereign states began to emerge as geopolitical units with the demise of the feudal system in Europe in the thirteenth century, some six hundred years before some states first began to reimagine themselves as the political vehicle for a particular nation or people. These states were generally seen as the private property of dynastic monarchs, rather than as the common property of a people. It was not until power began to pass from the monarchs to the new bourgeois elites, most visibly in the French and American revolutions of the late eighteenth century, that the idea of the nation state was born.

Yet to a large extent the idea embodies a fundamental contradiction. Sovereignty implies a fundamental equality between states, yet nationalism is predicated on the idea that one's own nation is somehow superior to or better than all others. In a world of competitive governance, the principle of sovereignty would, if anything, be strengthened, but feelings of nationalism would have no place.

Nor would it be appropriate to speak of "international relations" in such a world, because the relations would not be between "nations" or nation states. They would, rather, be between private cities, or "club states," or whatever else we decide to call the new kinds of polity envisioned in this book. Multilateral organizations would no doubt continue to exist, but not the United Nations, which is, as the name implies, a club reserved for nations.

The rise of the nation state was characterized by the increasing tendency to recognize only similar units as legitimate actors on the global stage. Nation states empowered only like types. Political elites benefited from decreasing the set of plausible institutional alternatives from which their citizens could choose. The United Nations has played a key political and ideological role in this narrowing of our political possibilities. The decline of the nation state will necessarily entail the death of the United Nations, as one correlate of a more fundamental change – the end of nationalism.

* * *

There are three main ways in which nationalism hinders the emergence of competitive governance. Firstly, it stokes hostility towards immigration, and so reduces the freedom of movement that is essential to a Tiebout world. Secondly, it encourages citizens to view their territory as sacred and nontransferable, which hinders the territorial reorganization that is also necessary for competitive governance to work. Finally, it fosters a quasi-religious attitude to citizenship.

In this chapter, I'll explore each of these problems in detail, and try to imagine how things might be different in a world of competitive governance. Attitudes to international migration would be very different in a Tiebout world. Politics

would compete for immigrants, and welcome them as valuable taxpayers. Territory would be seen as a fungible resource, pieces of which could be sold off if necessary, or swapped with other states when mutually convenient. Last but not least, the residents of city-states would have a rather prosaic attitude towards citizenship, seeing themselves more as members of a club than as brothers in arms. I'll conclude by asking how likely these changes are. If a global system of competitive governance depends on the decline of nationalist feelings, what are the prospects for such a radical shift in human sentiment?

* * *

The first way in which nationalism hinders the emergence of competitive governance is by stoking hostility towards immigration. Nationalism involves a sacred bond between each people and "their" territory. People who identify with a particular nationality often believe they have a natural right to reside in the national territory, and that other people may only enter with their permission. This is clearly nonsense; there is no such thing as "Jewish land" or "Palestinian territory." But, as these particular examples remind us, the patent absurdity of the idea is no obstacle to its powerful grip on the human mind.

This nonsense is transformed into reality by means of increasingly cumbersome restrictions on freedom of movement in the form of immigration authorities, passports, and visas. It is easy to forget that these are all comparatively recent developments; international travel in the nineteenth century was largely free of such encumbrances. This convoluted system of obstacles makes labor much less mobile than capital, and therefore less powerful. It also encourages citizens to believe that any jobs created in "their" country somehow belong to them, and to object when immigrants "take our jobs," or when "American jobs" are outsourced to China. If the concept of national territory is nonsense, the idea that jobs can have a nationality too is nonsense on stilts.

The legal restrictions on immigration are ultimately backed up by physical barriers. Take the US-Mexico border for example. A third of the border is now fenced, and most of the rest is in areas so remote or rugged as to make fences pointless or impractical. Some parts of the fence are 17 feet high, with metal plates extending ten feet below ground to prevent tunneling. Over 17,000 US Border Patrol agents are on the look out for anyone who manages to get past the fence. They patrol in cars and all-terrain vehicles, on quad bikes and horses, in boats, planes and helicopters. In the center of El Paso, where it is easiest for people to dash across the border from Ciudad Juárez, the entire border is floodlit. There is even a special unit to chase migrants through the city's storm drains, while robots are sent into sewers to check for holes, and ground-penetrating radar scans for tunnels.³⁹

These barriers reflect popular sentiment. Anti-immigration policies win votes. Indeed, democracies have done far more to restrict global migration than autocratic states. Autocracies have tended to restrict *emigration*, which affects

³⁹ See <http://www.economist.com/node/21538750>

only their own citizens, while democratic states tend to restrict *immigration*, which affects the whole of the rest of the world. A 2004 estimate put the total spent by just five industrial countries on keeping out economic migrants at 17 billion dollars.⁴⁰ The budget for border enforcement and immigration in the US quadrupled in the decade prior to 2012.

How would attitudes to international migration differ in a world of competitive governance? With the decline of nationalism, it would be as illegitimate to limit someone's life chances on the basis of their place of birth as to exclude them on the basis of their sex or race. A person's place of birth would no longer be the single largest factor affecting their life chances, as it is today.

If labor were as free to move as capital, polities would compete for immigrants as fiercely as they compete for foreign direct investment today. Immigrants would be welcomed as valuable taxpayers. Their choice to join the same residential club would be seen by exiting residents as an endorsement of the values that led them to move there beforehand.

* * *

Nation states have a different attitude to their territory, compared to pre-national states like dynastic monarchies. In the Middle Ages and early modern era, kingdoms would happily sell off a part of their territory, or swap territory with other states simply, for example, because the king's daughter married. The practice remained common throughout the nineteenth century; the United States purchase of the Louisiana territory from Napoleon for \$15m (\$320m in 2012 dollars) is the most famous example. Nation states today, by contrast, tend to view their territory as sacred and nontransferable. Some constitutions even assert that the national territory is inalienable, and enjoin politicians to respect its "integrity."

It was just such a constitutional obstacle that put an end to plans in Honduras to build free cities. When the Supreme Court declared the legislation permitting the Special Development Regions to be unconstitutional, the integrity of national territory was one of the main concerns cited by the judges. In a similar vein, Greek opinion was outraged in 2010 when a German politician advised the country to sell off their islands in order to pay off some of the national debt.

This attitude to territory hinders the development of competitive governance because competition between states cannot flourish without territorial reorganization. In a Tiebout world, states that succeed in attracting more immigrants may need more land to accommodate their growing population,

⁴⁰ Martin, Philip. 2004. "Migration." In *Global Crisis, Global Solutions*, edited by Bjorn Lomborg. Cambridge University Press.

while states that are losing tax revenue due to a declining population may wish to sell off some of their territory, either to another already-existing sovereign, or to a new start-up state.

Michael Strauss, an expert in international law, sees no legal reason why countries have stopped buying and selling land. "It's a totally legitimate way for sovereignty to change under international law," he says. The obstacles are more emotional than legal. Nationalist feelings are by now so deeply ingrained in the minds of many that few politicians would dare suggesting their country sell off national territory, or cede sovereignty over even a small patch of land by a merely commercial transaction.

The nation state, with its emphasis on patriotic feeling and ethnic loyalty, is an inherently non-market form of organization, predicated on ties that supposedly go beyond "mere" financial transactions. The integrity of national territory is a sacred value, and trading sacred values for money is what the psychologist Philip Tetlock calls a "taboo tradeoff." When asked to make such tradeoffs, people tend not to analyze them in a calm and rational way, such as by weighing the costs against benefits, but instead exhibit moral outrage. They also become increasingly inflexible in negotiations, especially when offered money. People consider trading sacred values for money so morally reprehensible that they recoil at such proposals.

It is this attitude to territory that must come to an end if we are to move towards the kind of world I envisage in this book, a world in which all political ties are reduced to essentially financial matters, where polities become simply private clubs operating ultimately for profit.

In terms of David Priestland's trichotomy, what I want is the victory of the merchant over the soldier and the sage. In his book, *Merchant, Soldier, Sage: A New History of Power*, Priestland argues that throughout most of history these three "castes" have struggled for predominance over a fourth, the worker. Most societies, he thinks, are based on an alliance between two of these three castes. The ancient empires of Egypt, China, and Mexico were led by aristocrats with warrior and landowner values (soldiers) in close alliance with priests (sages), who supplied their rule with theological legitimacy. The merchant was tolerated for bringing wealth through trade, but also resented for being cleverer and often richer than traditional elites.

It was not until the late seventeenth century that merchants first emerged as a dominant caste in England and Holland. Priestland regards the financial crisis of 2008 as the unfortunate consequence of this continuing dominance, and looks forward to a time when the sage (this time in the form of technocrats and policy wonks) will regain predominance and put the merchant in his proper subservient place. To my mind, however, the best hope for humanity lies in taking merchant values to their logical conclusion, so that even geopolitics is determined purely by market forces.

* * *

The third and final way in which nationalism hinders the emergence of competitive governance is by fostering a quasi-religious attitude to citizenship. Strictly speaking, citizenship simply denotes the link between a person and a state; a citizen of a given state normally has the right to live and work there, among other things. Nowadays, however, it is often conflated with nationality. There is no mention of citizenship in the Universal Declaration on Human Rights, for example, but Article 15 states that “everyone has the right to a nationality.”

By eliding the crucial distinction between citizenship and nationality, the Universal Declaration on Human Rights bolsters the view that people have transcendent duties towards the states of which they are citizens. Instead of a contract like any other, citizenship is seen as something sacred. Thus when the psychologist Philip Tetlock asked students at American universities whether people should be allowed to pay for the right to become a citizen, or sell their vote in an election, most of the students thought these practices were unethical and should be outlawed. But their responses went well beyond disagreement: they were outraged that anyone would even consider legalizing these practices, and found the question insulting.⁴¹

The same quasi-religious attitude to citizenship can also be seen in the oaths of allegiance that people must sometimes swear when acquiring a new citizenship. All immigrants who wish to become naturalized American citizens, for example, must swear an oath in which they promise to “bear true faith and allegiance to” the United States. The language of “allegiance,” and “faith” makes it clear that this is no ordinary relationship, but one that demands sacrifice and duty.

Dual citizenship is correspondingly regarded with suspicion. Immigrants commonly have to renounce their old citizenship when taking on a new one, while the countries they leave often disown emigrants naturalised abroad.⁴² America's citizenship ceremony continues to demand that candidates “renounce and abjure all allegiance and fidelity to any foreign prince,” and in 1930 the League of Nations stated that “every person should have a nationality and should have one nationality only.” The historian and diplomat George Bancroft summed up this attitude well when he declared, in 1849, that it was as wrong for a man to have two countries as it was for him to have two wives.

These restrictions are, if anything, getting tighter. A poll in May 2011 showed that over 60 per cent of Dutch adults find dual citizenship undesirable, and since 1 January 2012 new citizens in France have been required to sign a charter accepting that they “will no longer be able to claim allegiance to another country while on French soil.”⁴³

Peel away the lofty political rhetoric in which these restrictions are cloaked, however, and all that remains is naked political protectionism. By forcing

⁴¹ See Pinker, *Blank Slate*, p.277.

⁴² See <http://www.economist.com/node/21542394>

⁴³ See <http://www.economist.com/node/21542394>

citizens to choose one nationality only, or denying them access to multiple passports, the rulers of nation-states betray their desire for people to live, work, pay taxes, draw benefits and die in the same place they were born. The tightly controlled system of citizenship allows nation states to secure “enormous customer lock-in,” as Patri Friedman puts it. “People complain about their cellphone plans that are like two years,” he observes, “but think of the effort that it takes to change your citizenship.”⁴⁴

Rather than making a fetish out of nationality, a world of competitive governance would rely on residence (especially tax residence) as the main criterion for an individual's rights and responsibilities. Those who lived and paid their taxes in a particular state would be treated in the same way as any other resident, and better than citizens who lived overseas and didn't pay taxes.

Citizenship would no longer be about “duties.” Instead it would be seen as a contractual relationship that people may freely enter into with various polities, in which mutual obligations are specified between the resident and the governing authorities, like the contract between a club and its members. Just as one can be a member of many clubs, there would be no limit on how many citizenships one could have in a world of competitive governance. If you divided your time between five different polities, and paid taxes in all of them, you could have five citizenships.

* * *

What about loyalty? Could there still be pride in one's community and a sense of belonging in a world of competitive governance? Of course there could. There could even be a kind of patriotism, but it would not be based on membership of an imaginary ethnic tradition; it would not be nationalism. It would be based on a conscious decision to live in a country and abide by its rules rather than on an accident of birth. That encourages a better form of cohesion and commitment than one that invokes atavistic ethnic prejudices. Besides, being born in a country is no guarantee of loyalty; history's worst traitors have been true-born citizens, and some of those who fight most enthusiastically for a country are immigrants who have paid a high price to get there.

A nation is a symbolic tribe. It is a *tribe* in the sense that it evokes our sense of tribal loyalty, primitive emotions that were sculpted by natural selection at a time when our ancestors lived in small bands of hunter-gatherers. It is *symbolic* because we recognize other people as members of the same tribe not because we have known them personally all our lives, but because they share the same symbols (passports, flags, and so on). There is no scientific justification for separating out “the American people” or “the Chinese” as distinct ethnic or cultural entities. An alien from outer space would not be able to make any sense

⁴⁴ Cited in

<http://www.wired.com/science/planetearth/news/2008/05/seasteading>

of these categories. They exist only because of the symbolic constructions that history has thrown up.

The problem is not the symbolism but the tribalism. All communities larger than primordial bands of hunter-gatherers, or small villages of face-to-face contact, are symbolic constructions. The problem with nations lies, as Benedict Anderson pointed out, “in the *style* in which they are imagined” (emphasis added). Unlike, say, traditional Javanese farmers, who imagined their communities as “indefinitely stretchable nets of kinship and clientship,” nations are imagined as tribes, that is a having relatively sharp, finite boundaries that are extremely difficult to cross. A Javanese farmer might become a member of another kinship network simply by marrying, but acquiring a new nationality is not so easy. It is this sense of separateness that facilitates a hostility towards outsiders that, until the birth of nationalism in the nineteenth century, was the exclusive preserve of hunter-gatherers. Emperors and kings had fought wars for centuries before the rise of nationalism, of course, but these were not fought in the name of an exclusive ethnic group. As late as 1780, for example, the armies of Frederick the Great were heavily staffed by “foreigners.”

The loyalty inspired by a tribe is absolute, transcendent, and sacred. Nationalism gains much of its strength from inspiring this kind of loyalty, which has led thousands of men and women to perform acts of great courage and heroism, as well as acts of great cruelty and evil. If it is true that it takes religion to make good people do bad things, then nationalism must count among the most powerful religious forces of all time.

There would still be room for loyalty in a world without nations, but it would be different. It might be more like the kind associated with the “loyalty cards” offered by supermarkets to their customers. These cards help build up some kind of emotional attachment to the supermarket, but nobody pretends that this is what the relationship is all about. Ultimately, the loyalty here is just a very thin veneer of sentiment covering fundamentally commercial arrangements.

* * *

A world of competitive governance will both require and foster a genuine cosmopolitanism, in which people think of themselves as citizens of the world rather than of this or that nation, as members of the private city or cities that they have deliberately chosen, without regard to the color of their skin or where they happened to be born.

Cosmopolitanism is different from internationalism. Internationalism presupposes a system of nation-states; one can only be in favor of harmony between nation-states if one is first in favor of nation-states themselves – that is, if one is a nationalist. Yet a central precept of nationalism is that people owe more duties to other members of the same nation than to members of other nations, so there is always a fundamental contradiction at the heart of internationalism. This is in sharp opposition to the spirit of cosmopolitanism that animates the idea of competitive governance, in which no polity is seen as

intrinsically better than any other. The residents of any given polity will no doubt prefer it to most others, since they have chosen to live there, but they will not think that it is therefore better for everyone. On the contrary, the fact that others have chosen to live in other polities will make it abundantly clear that different people have different tastes, and therefore that there is no such thing as a “best” state.

* * *

Nationalism may be a relatively new phenomenon, but in the two centuries or so since it first began to emerge it has come to exert a huge influence on human psychology. Even the least patriotic citizens get caught up in its spectacular rituals, such as the Olympic games and the World Cup, waving national flags and singing national anthems. If a global system of competitive governance depends on the decline of such feelings, what are the prospects for such a radical shift in human sentiment?

Writing in 1983, the political scientist Benedict Anderson was not optimistic; “the ‘end of the era of nationalism,’ so long prophesied, is not remotely in sight” he noted glumly [*Imagined Communities*, p.3]. But nationalism is a relatively recent phenomenon, and it could conceivably perish as quickly as it came into being. If we are to go beyond tribalism to some less “sacral” and more prosaic attitude to group membership, then perhaps our best hope lies in the disenchantment that comes with commoditization – the reducing of everything to monetary relations and commercial exchanges.

Marx, together with many other bourgeois thinkers, scorned the tendency of capitalism to reduce everything to the cash nexus. Yet to my mind there is something wonderfully liberating about the death of sacred values and the triumph of means-end instrumental reasoning. It may be wrong to take the romance out of marriage by defining it, like Kant did, as a contract for the mutually exclusive use of each other’s sex organs. But it could only be a good thing if we were to take the romance out of citizenship by means of a similar reductive move.

We might then all aspire the kind of cosmopolitanism that was once the preserve of the aristocracy, as described so brilliantly by Joseph Roth in his short story, “The Bust of the Emperor” (1934). The protagonist of the story is Count Franz Xaver Morstin, “a man above nationality, and therefore of true nobility.”

Had anyone asked him, for example – but to whom would such a senseless question have occurred? – to which ‘nationality’ or race he felt he belonged, the Count would have felt rather bewildered, baffled even, by his questioner, and probably bored and somewhat indignant. And on what indications might he have based his membership of this or that race? He spoke almost all European languages equally well, he was at

home in almost all the countries of Europe. His friends and relations were scattered about the wide colourful world.⁴⁵

⁴⁵ Joseph Roth, "The Bust of the Emperor," translated by John Hoare, in *Three Novellas*, New York: The Overlook Press, p.44.

Imaginary city-states of the future – a glimpse at the world in 2100 AD.

“Only a fool, or a prophet, would try to prophesy the range and limits and characters of the communities after, for example, 150 years of the operation of this framework.” (Nozick, 1974: 332)

Abramograd

The origins of Abramograd lie in the financial crisis that wrecked the global economy in 2008. Greece was particularly badly hit, and in a bid to stave off bankruptcy it auctioned off one of its islands to the highest bidder. The buyer was a consortium of Russian billionaires, who saw their investment as way to protect their business interests from the grasping hands of governments. At first, the place wasn't much more than a glorified private tax haven, but as the oligarchs began to renovate the infrastructure and build fantastic holiday homes for themselves, the consequent influx of labor created a need for shops, schools, and the other trappings of city life. Within a decade, a thriving economy had sprung up on Abramograd, as the island came to be known, and more companies were attracted by the absence of any corporation tax.... ETC... ETC...

Castroville

Castroville has a dilapidated charm all of its own. Economically, it is a mess. Unemployment stands at 30 per cent, and reaches over 50 per cent among those aged under 25. There are frequent power cuts, the roads are full of potholes, and the houses are run down. But nonetheless, people stay. There has been no mass emigration, as there was with Pyongyang when North Korea collapsed in 2021. “We just like it here,” says Rainbow River, who lives in a yurt village near one of the pristine beaches....

Cocainopolis

This started off as a free city in Honduras, which soon became a “drug haven” ...

Ecotopia

When Ernest Callenbach published his science fiction novel Ecotopia in 197x, little did he imagine that his fanciful plot would one day become historical reality. Yet that is exactly what happened in the year 2025, when the states of Montana, Washington and ... seceded from the US to form an the world's first “green country.”

Celebration

In the early 1990s, the Disney Development Company established the Celebration Company to spearhead the development of a new town in the southern portion of the Reedy Creek Improvement District. Total investment for

the project is estimated at US\$2.5 billion. The master plan was developed by Cooper, Robertson & Partners and Robert A. M. Stern, and the extensive landscape, parks, trails and pathways were designed by the San Francisco firm EDAW (now AECOM). Modeled on an early 20th-century architectural style, Celebration was named the "New Community of the Year" in 2001 by the Urban Land Institute. Disney CEO Michael Eisner took an especially keen interest in the development of the new town in the early days, encouraging the executives at Disney Development Company to "make history" and develop a town worthy of the Disney brand and legacy that extended to Walt Disney's vision of an Experimental Prototype Community of Tomorrow (EPCOT). DDC executives collaborated extensively with leaders in education, health and technology in addition to planners and architects to create the vision and operating policies for the town.

Other city-states will include:

1. A conservative state (anti-abortion, no gun control) like Texas
2. A socialist state like Cuba
3. A state like Singapore
4. A free city like a RED in Honduras
5. A warlike state – a neo-Nazi state
6. A banking state like Switzerland
7. A state with lots of welfare like Sweden
8. A poor state like Mali
9. An oil-rich state like Angola
10. A pirate state (?)
11. An Islamic state
12. A Mormon state
13. The Ashram
14. Waterworld (a seasteading state)

What languages will be spoken in these states?