Competition in Government

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> *Competition is essentially a process of the formation of opinion: by spreading information, it creates that unity and coherence of the economic system which we presuppose when we think of it as one market. It creates the views people have about what is best and cheapest, and it is because of it that people know at least as much about possibilities and opportunities as they in fact do.*
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> —Friedrich A. Hayek,
> "The Meaning of Competition" (1946)

Whenever we praise or condemn a government program or advance a proposal for reform, we are always positing some principle for choosing good policy. The economist says that policy should promote economic efficiency—the maximum output, measured by value to consumers, from a given input of scarce resources. The political scientist may say that policy should fairly represent the views and interests of citizens as mediated by political institutions they have consented to. For libertarians, the overarching standard is individual freedom; for conservatives, it is the preservation of time-tested social norms and institutions; for liberal communitarians, it is some version of social equality, social justice, or social solidarity.

These are academic and philosophical criteria, elaborated and argued over in scholarly texts. In practical politics, they are simplified and given populist twists. Conservative Republicans often say that policy should promote

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"economic growth." Promoting growth is different from promoting efficiency or freedom, and the difference has a political purpose—to build popular resistance to redistributionist policies by focusing attention on growing the pie rather than dividing the current pie. Liberal Democrats often say that policy should promote the welfare of the poor or disadvantaged—which may or may not accord with academic conceptions of social justice, depending largely on electoral considerations. Interest-group lobbyists often assume that preserving the environment or the family farm or the prerogatives of teachers unions are self-evidently desirable, but the best of them attempt to tie their parochial interests to broader principles such as growth or fairness. Citizens who are neither economists nor philosophers nor politicians tend to want it all: efficiency *and* equality, growth *and* fairness, freedom *and* justice. Politicians understand our dilemma and try to help out, emphasizing that their programs would achieve all good things and downplaying the trade-offs among them. Especially as election days approach, conservatives are compassionate and liberals are fiscal skinflints.

Competition as a Policy Principle

I want to propose a new entry in the constellation of political lodestars: the principle of competition. This is the principle that all things of value should be provided by numerous suppliers in rivalry with each other. It may sound odd to suggest competition as a new principle, for few ideas are invoked more frequently in American policy debate. But the conventional usage is reflexive and superficial, and often opportunistic and insincere. We all favor competition except when it comes to ourselves—that is, to the things we really care about—where we do everything possible to avoid it. When a politician or lobbyist says he favors competition and only wants a level playing field, our first instinct is to grab for our wallets. My argument is for a more systematic and principled version of competition. I believe it holds promise for solving many serious problems in government, for seeing familiar issues in new and productive ways, and for building popular support for policy reform.

Today there are just two areas of policy where competition is the governing principle. The first is antitrust law, which polices cartels and monopolies and certain business practices to promote market competition. The second is freedom of speech, religion, and political association, enshrined in the First Amendment. In both cases, we abstain from judging the quality or desirability of the goods and services, ideas, religions, or political programs being supplied; instead, we simply insist that everyone be permitted to supply whatever he or she likes and let the judge of value be the choices of consumers in the market for goods or the market for ideas.

I hope to persuade you that the principle of competition in these realms possesses important advantages of wider application. To make my case I must first overcome the common supposition that competition is a background condition—a fact of life rather than a social construction—or, worse, is a primitive background condition that needs to be suppressed in order to achieve higher social ends. In evolutionary biology, competition is the consequence of the scarcity of resources in relation to the instincts of living things for self-preservation and procreation; in economics, it is the consequence of the scarcity of resources in relation to temporal human needs and desires. But human progress consists in large part of reducing scarcity through economic growth and technological improvement, and of cultivating modes of social organization more rational and aspiring than the "nature red in tooth and claw" of our simian ancestors. So it is easy to see how competition would be regarded as feral and vestigial, something to be transcended rather than nurtured. This attitude may be reinforced by the circumstance that, in our private lives and callings, we so often encounter competition as an imposition on our autonomy and aspirations for self-realization, and seek constantly to evade its tethers: it is a short step to transfer our personal feelings to our thinking about politics and social organization. Competition may be good enough for the tawdry concerns of commerce, as in antitrust, and may be inevitable in a society of great political, religious, and cultural diversity, as in freedom of speech, but it is hardly something to be extended to fields where it is not absolutely necessary. Even in these two areas, competition is not so much purposive policy as the consequence of self-denying ordinances: the First Amendment simply carves out an area where the majority may not legislate, and antitrust is a similar device for abstaining from government favoritism toward one or another industry.

Among intellectuals, especially, competition is likely to be thought of as an obstacle to sound policy. Many political thinkers are communitarians or socialists who regard competition as part of the capitalist creed, and an aspect of selfish private interest that needs to be regulated and suppressed where the public interest is concerned. And policy advocates of all persuasions are, after all, advocating that society be organized in a certain way that is different from the existing order of things; achieving the desired end usually requires state coercion—in other words the exercise of monopoly power, which is undermined by competition. Thus, competition among nations and among the American states in business regulation, taxation, environmental policy, and other areas is said to produce a "race to the bottom," with each jurisdiction obliged by the threat of citizens and business firms migrating elsewhere to supply weaker regulation or lower taxes than the public interest is said to require.

Benefits of Competition

As against these criticisms, consider the following five advantages of competition as a policy principle:

• First, competition is a powerful force for durability, resilience, and progress over time. We know from evolutionary biology, and from the performance of competitive versus controlled economies, that competition tends to produce forms that are well adapted to their environments, that resist threats to their well-being, and that improve continuously in response to changing circumstances. Competition is more than a background condition: it is not only the *result* of the scarcity of means in relation to ends, but also the *cause* of success in accommodating to that condition. And the condition of scarcity is a permanent one, and as essential a fact of political life as of biological and economic life. Although particular kinds of material scarcity such as food and shelter are relieved over time, scarcity can never be eliminated, because human desires are also ever-growing and some of them, such as the desires for honor, knowledge, and eminence, are comparative rather than absolute. The allocation of government revenues among an infinity of worthy causes is no less contentious today than it was a century ago, and it will be equally contentious a century from now.

• Second, competition is, at any point in time, an important source of discipline. One who is working in direct rivalry with others tends to work longer and harder and to be more focused on production rather than consumption, either out of hope for gain, fear of failure, or sheer love of the game. Competition is also a "reality check," obliging each of us to take account not only of our own interests and preferences but those of others. The business firm, professor, doctor, or political leader who must compete with others for the allegiance of consumers, students, patients, or voters tends not only to work harder but to think more clearly and objectively about the usefulness of what he or she has to offer. In this manner, competition tempers excessive self-confidence among adherents of particular business methods or political creeds or academic or professional fields: approaches that are not useful or appealing to a wider community lose out to those that are.

• Third, competition tends to moderate social conflict. The judgments of the marketplace, and of other competitive procedures under established rules, are impersonal in the sense that they constitute the aggregation of large numbers of small, essentially anonymous individual decisions. It is a great boon to have important decisions made in this manner rather than by identifiable individuals and groups, whose motivations, sincerity, and legitimacy can always be questioned by those who oppose their decisions. One of the reasons that the sports and business pages of the newspapers are such a relief from the news and editorial pages is that they report on the results of competitive processes that are, for the most part, immune to the bluff, bombast, and "spin" that characterizes politics. (The outrage that attends "hometown refereeing" in sports and accounting scandals in business underlines the point—such behaviors are conventional in politics.) Election nights are similarly exhilarating in providing unquestionable judgments that bring the season of political campaigning to a decisive end (usually). Societies that have mastered the art of transferring government power through peaceful acquiescence in election results are rightly regarded as having achieved a high level of political civilization.

• Fourth, and closely related to the first three, competition generates accurate information—in a word, truth. As Oliver Wendell Holmes put it in a celebrated Supreme Court opinion, the theory of the First Amendment is "that the best test of truth is the power of the thought to get itself accepted in the competition of the market."[1] The case concerned political truth—the prosecution of a World War I antiwar agitator—but the principle applies equally to the truth of economic information in commercial and financial markets, biological information in the quest for cures for diseases, and, thanks to the University of Iowa business school, the electoral prospects of political candidates. Useful information on any question of social importance is typically highly dispersed and subtle— impacted in subjective opinions and particular experiences of wide variety, withheld for reasons of personal advantage, and subject to uncertainty and disagreement. In economic markets, competition among sellers and buyers is the engine that elicits dispersed information about conditions of supply and demand, consolidates it into simple price and quantity data, and transmits it to those who can use it.[2] Appreciation of the function of competition as a discovery mechanism has led to the increasing use of contrived competitive procedures for purposes of summoning existing knowledge and spurring efforts to produce better knowledge. Examples include financial futures markets; the grant-making

1. *Abrams v. United States,* 250 U.S. 616 (1919) (dissenting opinion).

2. That is the teaching of the profound article of Friedrich A. Hayek, "The Use of Knowledge in Society," 35 *American Economic Review* 519 (1945), reprinted in Hayek, *Individualism and Economic Order* (1948, 1969).

procedures of the National Institutes of Health and the National Science Foundation; a variety of private grant and prize programs in science, scholarship, and literature; and "prediction markets" such as the Iowa election markets and the ill-starred Pentagon brainstorm for using contract markets to gather anonymous information about terrorism and other geopolitical risks.[3]

The "information economy" in all of these guises illustrates that competition is much more than a primeval background condition: it is also a thoroughly modern and sophisticated device for pursuing a variety of ends both practical and elevated. And all are highly pertinent to government policy—where the problems of dispersed and concealed information and contested interpretation are particularly severe. Where there is just one policy and therefore no direct information about the effects of alternative policies, claims about the policy's operations and consequences may be made with abandon—citizens who are not directly involved in the policy are in a very poor position to judge its merits, and those who are directly involved, and therefore better informed, typically have a parochial interest in its maintenance and expansion.[4] Policy competition, both between the policies of different jurisdictions and within the policies of individual jurisdictions, has great potential for improving the ratio of facts to bombast in political debate and the accountability of public officials.

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3. The essential insights and many examples of information markets are entertainingly related in James Surowiecki, *The Wisdom of Crowds* (2004). Cass R. Sunstein, "Group Judgments: Deliberations, Statistical Means, and Information Markets," AEI-Brookings Joint Center for Regulatory Studies, Working Paper 04-17 (September 2004), posted at http://aei-brookings.org/admin/authorpdfs/page.php?id =1026, differentiates rigorously (as Surowiecki does not) among different procedures for eliciting the wisdom of crowds—deliberation among members of a group, simple averaging of the judgments of individual members, and market competition among members to produce the most accurate judgment. See also Justin Wolfers and Eric Zitzewitz, "Prediction Markets," 18 *Journal of Economic Perspectives* (Spring 2004); the website of the Iowa Electronic Markets, www.biz.uiowa.edu/iem; and the several other information market websites cited in Sunstein, *op. cit.*, at 46.

4. The effect of the absence of counterfactual information in preserving harmful policies is analyzed in Sam Peltzman, "Regulation and the Natural Progress of Opulence," AEI-Brookings Joint Center for Regulatory Studies, 2004 Distinguished Lecture (September 8, 2004), posted at www.aei.org/events/eventID.866,filter.all/ event_detail.asp.

• Fifth, competition has greater political appeal than other policy principles, both general ones such as economic efficiency, economic growth, and social justice and more specific ones such as privatization and voucherization. Competition is much less abstract and dependent on an analytical apparatus than the other principles, and much more connected to the daily lives and immediate practical knowledge of average citizens and voters. Even when we don't "like" competition in our personal and professional lives or in rooting for our favorite sports teams, we are intimately familiar with its operation and effects. Competition may be a "Hard America" rather than "Soft America" virtue,[5] but it is much less ideologically loaded than related terms such as "pro-market," "market oriented," and "privatized." It is a feature of many areas of life other than commercial markets and, in commercial markets, it is the feature that constrains business and protects consumers. And when it comes to government policy, we are all consumers. Consider the paradox that so many successful people in finance, entertainment, scientific research, and the media—people who have prospered in environments that are at once highly competitive and highly productive and admired, indeed among the crown jewels of American society—are nevertheless political leftists who favor the preservation of monopolies in schooling, medical care, and retirement finance, which are among the most troubled and least productive sectors. The reason, I suggest, is that intellectuals and political activists of classical liberal disposition have done much less than they could to recommend the social advantages of competition broadly and forthrightly.

Competition versus Choice

That is my litany of competition's virtues, and notice that it does not include "choice." Individual choice and "autonomy" are important values in contemporary society and the guiding rhetorical principle for a variety of causes. Those who favor liberal policies toward abortion are "pro-choice"; proponents of vouchers for parents to sent their children to private schools are for "school choice"; Milton Friedman titled his classic paean to the free market "*Free to Choose*." I am myself strongly attracted to individual choice as both a moral and political principle, but here I want to emphasize not the consumption side but the production side of competitive arrangements—not the tendency of competition to provide individuals with a smorgasbord of alternatives to choose

5. Michael Barone, *Hard America, Soft America: Competition vs. Coddling and the Battle for the Nation's Future* (2004).

from, but rather its tendency to regulate conflict, strengthen and discipline institutions, and channel human ambition so as to promote the public good.

These attributes of competition provide answers to both liberal and conservative critics of choice—liberals who believe that most people are less interested in choice than security and are anyway poorly equipped to make good choices among a range of complex alternatives[6], and conservatives who fear that our modern preoccupation with personal gratification and consumerism is a threat to sound cultural values and a public-spirited citizenry.[7] It is certainly a worthy and wonderful thing that competitive markets provide a wide range of choice, and opportunities for fulfilling variegated individual preferences, in clothing and fashion, food and drink, travel and recreation and entertainment, and other areas of (mostly) uncontroversial private consumption. But in many other areas, such as schooling, insurance, and professional services from accounting to medical care, the range of personal preferences is likely to be much narrower and the consequences of personal choice less exclusively private. In these areas, most people will be less concerned with their "freedom to choose" than with the intrinsic quality of what is being supplied to them and to others around them. In such cases, choice may appear as more of a burden than it is worth. And the certainty that some people will make poor or strange choices (for example, for cult schooling or quack medicine) will tend to divert attention from the more important issues at hand—which are the excesses, abuses, and self-indulgences that arise in every circumstance of political and economic monopoly.

Economic Regulation

I will now illustrate and elaborate these general arguments with concrete examples in four areas: economic regulation, political structure, public expenditure, and ideas and information. The first, economic regulation, is the most obvious and least problematic, and I will discuss it only briefly. Since the 1970s, the deregulation movement, technological progress, and the growth of global markets have unleashed the competitive gale on many once-proud

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6. Barry Schwartz, *The Paradox of Choice: Why More Is Less* (2004); Steven Pearlstein, "Choice Is Overrated," *The Washington Post*, September 10, 2004, p. E-1. See also Cass R. Sunstein and Richard H. Thaler, "Libertarian Paternalism," 93 *American Economic Review* 175 (2003).

7. Robert H. Bork, *Slouching toward Gomorrah: Modern Liberalism and American Decline* (1996). See also Ryszard Legutko, *Society as a Department Store* (2002).

American monopolies—Detroit automobile manufacturing, Wall Street finance, Bell System telephone service, television network news, and many legally protected labor cartels and innumerable local monopolies in such things as banking and retailing. In his AEI book, *The Competition Solution: The Bipartisan Secret behind American Prosperity*, Paul London argues that America's general laissez-faire approach to such socially disruptive economic change, which generated tremendous political pressures for protectionist responses, has been the single most important factor in bringing the U.S. economy to its current position of relative and absolute preeminence. That the response has been, as London demonstrates, both persistent and bipartisan is evidence of the depth of appreciation of the principle of competition in our political culture, at least where matters of private commerce are concerned.

Nevertheless, there remains a great deal to be done. Federal and state authorities still egregiously over-regulate many critical sectors such as energy, finance, insurance, and telecommunications, limiting competition not only among firms but in the use of valuable resources such as the electromagnetic spectrum, and protecting strong monopolies such as the New York Stock Exchange from technological progress. The deregulation movement has given way, following recent corporate scandals, to a new era of regulatory growth, especially at the Securities and Exchange Commission,[8] and we appear to be drifting toward imposing price controls on pharmaceutical drugs.[9] In all of these areas, the touchstone of reformist advocacy should be the principle of competition. The principle is not a complete guide to regulatory (or any other form of) policy; it does not resolve many important issues of efficient pricing, rules of conduct, the structure of intellectual property, and externalities among producers and consumers (as in network industries). But it takes us further in the direction of good policy than any other principle. As Hayek wrote many years ago: ". . . [W]e should worry much less about whether competition in a given case is perfect and worry much more whether there is competition at all. . .

8. See recent issues of Peter Wallison's AEI *Financial Services Outlook*, especially "Shooting from the Hip: The SEC Has Stopped Doing its Homework" (October 2004), "Sarbanes-Oxley As an Inside-the-Beltway Phenomenon" (June 2004), and "The SEC's Proposed Shareholder Voting Rule (April 2004)," posted at www.aei.org/publications/contentID.20040413154944744/default.asp; and James K. Glassman, "Fund Follies," AEI *On the Issues* (June 2004), www.aei.org/news/newsID.20609,filter./news_detail.asp.

9. Joseph Antos and John E. Calfee, "Of Sausage-Making and Medicare," AEI *Health Policy Outlook* (January 2004), www.aei.org/publications/pubID.19765/pub_detail.asp.

. [A] much bigger gulf divides competition from no competition than perfect from imperfect competition."[10]

Government Structure

My second example concerns the structure of government itself, where an examination of the American system illustrates two important points. First, that competition in government is not a novel concept or a conservative Trojan Horse, but rather is a principle of long and distinguished lineage. The second is that appreciation of the virtues of competition lies deep in American political culture in areas far afield of business and commercial policy.

To the American Founders, the state's possession of monopoly power was the beginning, not the end, of the challenge of providing good government. "The great difficulty lies in this," wrote James Madison in *Federalist* 51, "You must first enable the government to control the governed; and in the next place, oblige it to control itself." His solution was competitive government: "Ambition must be made to counteract ambition," he wrote, through a "policy of supplying by opposite and rival interests, the defect of better motives." This was achieved, first, through a federal system, in which the states were not administrative subdivisions of the federal government, but rather possessed considerable autonomous, sovereign power, and, second, through the division of the federal government into three departments or branches, each partially dependent on and partially independent of the others, and through the further division of the most powerful branch, the Congress, into two houses with different prerogatives and constituencies.

This extreme "separation of powers"—the most distinctive feature of American government—is often regarded simply as a means of keeping government ensnarled and at loggerheads and therefore limited in size. For that reason, it is often opposed by American advocates of bigger and more decisive government, many of whom would like to see the United States adopt a parliamentary system in which the executive branch is an auxiliary of the legislative majority. But that is a crude and incomplete account of the American system. Consider the following paradox: in the economic sphere, the well-understood consequence of competition is to *promote* output and growth—so why should we think of competition as *limiting* output and growth in the political sphere? The answer is that the separation of powers, and political

10. Friedrich A. Hayek, "The Meaning of Competition," *Individualism and Economic Order* 92 (1948, 1969).

competition among them, tends to produce government that is both limited *and* energetic. On the one hand, a very broad consensus is required to enact new legislation, which must win the assent of two separate majorities of the Congress, and then the president, and then (if the law is challenged) the courts. On the other hand, at least one branch of government is almost always open for business, capable of action when one or both of the others are in disarray.

The enabling, pro-growth tendency of competing powers was particularly conspicuous following the national elections of 2000, when the presidential vote and the U.S. Congress were essentially tied along partisan lines. The potential for serious political instability and governmental breakdown was ever present just as, we now know, the nation was about to encounter a grave security crisis in September 2001. But in late 2000, the Supreme Court stepped into the breach. In *Bush v. Gore*, it resolved the 2000 election finally and authoritatively, averting a constitutional crisis that would otherwise have led to protracted and unseemly machinations in the Congress and might have left the nation without a president for an extended period. Although the legal reasoning of that decision is open to serious criticism, I believe that Judge Posner has provided the last word on the matter: if the Supreme Court cannot resolve a constitutional crisis that the other two branches are incapable of resolving, even at some risk to its own reputation and doctrines, what's the Supreme Court for?[11] Then, in the spring of 2001, a change in party affiliation by a single Senator reversed the political majority of the Senate from Republican to Democratic, but left the presidency and the Executive Branch unaffected. Imagine if, in a period of international crisis such as that following the attacks of September 11, 2001, requiring decisive political leadership, our President had been preoccupied not only with responding to terrorist threats but with preventing minor legislative defections that could have toppled his government at any moment—as happens routinely, for example, in the parliamentary system of Israel.[12] The American system of competitive government provides both separated powers and redundant powers, powers that are not only checked but also balanced; the system is slow and painstaking

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11. Richard A. Posner, *Breaking the Deadlock: The 2000 Elections, the Constitution, and the Courts,* chapters 3–4 (2001).

12. It was precisely to avert such legislative undermining of executive leadership in the face of international crisis and domestic disarray that France, in 1958, abandoned its parliamentary system for an American-style presidency with an independent political base. See James W. Ceaser, "In Defense of Separation of Powers," in Robert A. Goldwin and Art Kaufman (eds.), *Separation of Powers—Does It Still Work?* 168 (1986).

in times of tranquility but agile and decisive in times of crisis.

Federalism is an even more important source of competitive government. Although federalism's virtues are often described as those of decentralization, laboratories of democracy, and closeness of public officials to citizens, the greatest advantage lies in the potential for competitive supply of government policy. In the early days of the American republic, the small number of states, and the dominance of a few large states such as Virginia and New York, made it possible for the states to act as an effective counterweight to the national government; as the late Peter Aranson has shown, the growth from thirteen to fifty states has introduced collective-action problems that have increasingly inhibited the states from resisting the expansion of federal power at their expense.[13] But policy competition *among* the states remains an important force for Madisonian discipline. This is the constant theme of AEI's Federalism Project, which has come up with an off-the-rack solution for practically every problem in state regulation and taxation: which is that state policies should apply to suppliers rather than consumers, because suppliers, especially large business firms, are more mobile and therefore policy elastic.[14] In this view, the closest thing to policy nirvana in American law is corporation law, which is supplied by the states in a true policy marketplace where corporations may choose their state of incorporation regardless of the locations of their headquarters or other facilities. It used to be thought that this produced a "race to the bottom," with states competing for charter business by providing laws that permitted incumbent managers ample leeway to wall themselves off from financial markets and corporate-control transactions, to the detriment of shareholders. Then a series of careful AEI studies, first by Judge Ralph Winter and then his student, Professor Roberta Romano of Yale Law School, showed that the race-to-the-bottom notion ignored the fact that incumbent managers were themselves subject to financial market competition, so that incorporating in states that unduly protected them would come at a price in lower equity values.[15] Corporation law is far from perfect, and the Winter-Romano thesis is not

13. "Federalism As Collective Action," March 5, 1995, unpublished manuscript on file with the author.

14. See the superlative essays of Michael S. Greve published as AEI *Federalism Outlook,* www.aei.org/publications/contentID.20038142219500221/default.asp.

15. Roberta Romano, *The Genius of American Corporate Law* (1993); Ralph K. Winter, *Government and the Corporation* (1978).

uncontroversial, but the best thinking suggests that corporation law is a race to the optimum, not the bottom. In her latest AEI book, Professor Romano has proposed extending the principle to the regulation of securities currently supplied as a national monopoly by the Securities and Exchange Commission.[16]

Another dramatic example of competitive regulation in practice is that of state usury laws controlling interest rates on consumer loans. From the colonial period to the late 1970s, all states had such laws, and they applied not to lenders but borrowers—that is, they controlled the interest rates a state's citizens were permitted to pay for loans, even from lenders in other states with different usury laws. Then a Supreme Court decision held that a state's usury laws could control the rates local banks could charge but not the rates its citizens could pay for loans from out-of-state banks.[17] Within a year, South Dakota abolished its usury law and Citibank relocated its credit card operations there and flooded the nation with unregulated consumer credit. Within five years, two-thirds of the states had reformed or abolished their usury laws, and the credit card revolution—one of the most beneficial developments in modern finance—was underway.[18]

The principle of competitive policy supply, which in Europe is called mutual recognition, holds enormous potential for reforming other areas of American law. Most states regulate insurance rates and services offerings despite the fact that insurance is a highly competitive industry. And they do so with great perversity: states that regulate automobile insurance rates heavily have markedly higher insurance rates as a result, and also higher highway accident rates. Almost all states impose "mandates" on health insurance, requiring that they cover a wide range of medical services from politically influential groups and putting insurance beyond the means of many people of modest incomes. Imagine the consequences if New Jersey were permitted to

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16. Roberta Romano, *The Advantage of Competitive Federalism for Securities Regulation* (2002).

17. The case, *Marquette National Bank v. First of Omaha Service Corporations*, 439 U.S. 299 (1978), interpreted a provision of the National Bank Act of 1933 and applied only to nationally chartered banks, but its policy was later extended by statute to state banks.

18. See Christopher DeMuth, "The Case Against Credit Card Interest Rate Regulation," 3 *Yale Journal on Regulation* 201 (1986), posted at www.chrisdemuth.com/id69.

regulate the rates of New Jersey—based automobile insurance companies, but that New Jersey citizens were free to purchase insurance from out-of-state suppliers, such as firms in Illinois which does not regulate auto rates. A little noticed but immensely important proposal announced recently by President Bush would do precisely this for health insurance, creating a national market in insurance regulation and therefore in insurance itself.[19] As in the case of usury laws, we would have a competitive market test of whether the numerous medical insurance requirements mandated by state laws are in fact worth their costs to consumers.

Consider finally the dilemma of state taxation of interstate sales through catalogs and Internet providers such as Amazon. At present there are two sides to this debate, both highly unattractive: the Internet providers propose to be permanently exempt from the sales taxes that apply to their bricks-and-mortar competitors in local markets, and their local competitors, along with the National Governors Association, propose the creation of a national body to collect the purchaser's state's tax on every interstate sale and remit it to the purchaser's state. But there is a third, competitive alternative, proposed in a recent AEI study by Michael Greve, that would shift state sales taxes from buyers to sellers, in the manner of Europe's Value Added Taxes.[20] Under this regime, the state of Washington would be free to tax all of Amazon's sales at whatever rate it wished—and Amazon would be free to relocate to Oregon.

With the growth of international markets, policy competition has become an increasingly important, and on the whole salutary, phenomenon. In Europe, the policy entrepreneur has been Ireland, which has cut its corporate and individual tax rates dramatically during the past decade, spurring an investment boom that has caused Irish wages to soar and prompting many other nations to follow suit. Eric Engen and Kevin Hassett have shown that the U.S. corporate tax, which fifteen years ago was among the lowest on the planet, is today (even after the Bush tax reductions of 2003) the highest of those of all the economically

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19. "Making Health Care More Affordable," www.whitehouse.gov/news/releases/2004/09/20040902.html. See also the "Health Care Choice Act" proposed by Congressman John Shadegg, johnshadegg.house.gov/News/DocumentSingle.aspx?DocumentID=5062.

20. Michael S. Greve, *Sell Globally, Tax Locally: Sales Tax Reform for the New Economy* (2003), full text posted at www.aei.org/docLib/20040218_book449.pdf.

developed nations excepting Japan.[21] Corporate taxes have always been particularly harmful economically and particularly appealing politically, but international competition is changing the calculus in a way that a President Kerry, despite his campaign rhetoric, would be obliged to recognize. The numerous efforts to "harmonize" the domestic policies of nation-states—in taxation, labor standards, environmental standards, and price regulation—are for the most part efforts to form policy cartels in response to the increasing mobility of commerce and finance; they should be resisted.[22]

As in the case of economic regulation, the principle of competition is not a complete guide to beneficial policy arrangements among political jurisdictions. Individual states have innumerable opportunities for exporting the costs of their domestic policies to citizens of other states, a problem policed (highly imperfectly) by the Supreme Court's "dormant commerce clause" doctrine.[23] The extraordinary growth of tort liability and of legal activism by the state attorneys general is due in part to obsolete jurisdictional rules that permit states to tax and regulate out-of-state firms and their dispersed shareholders.[24] Problems such as these are not problems of "excessive policy competition" but rather, as in the case of state sales taxation and insurance regulation, of inappropriate rules of policy competition; they are the jurisdictional equivalent of network externalities in economic regulation and interstate air and water pollution in environmental regulation.

Competition within Policies

Let us now move from the structure of government to the content of government policies, beginning with the challenge of education reform. The

21. "Does the U.S. Corporate Tax Have a Future?," *Tax Notes*, December 2002, full text posted at www.aei.org/docLib/20040401_TaxNotes1102.pdf.

22. Jagdish N. Bhagwati, *Free Trade Today* (2003).

23. Michael S. Greve, "Commerce and the Constitution," AEI *Federalist Outlook* (December 2002), www.aei.org/publications/pubID.57/pub_detail.asp.

24. Michael S. Greve, "States Rights on Steroids," AEI *Federalist Outlook* (September/October 2002), www.aei.org/publications/pubID.14296/pub_detail.asp, and "Free Eliot Spitzer!", AEI *Federalist Outlook* (May/June 2002), www.aei.org/publications/pubID.13928/pub_detail.asp; Richard A. Posner, "Federalism and the Enforcement of Antitrust Laws by State Attorneys General," Richard A. Epstein and Michael S. Greve, *Competition Laws in Conflict: Antitrust Jurisdiction in the Global Economy* 252 (2004).

persistent poor performance of our public schools has prompted a variety of reform proposals, most of which fall into two categories: First, efforts to promote "school choice" through the institution of voucher programs and charter schools. Second, efforts to make public schools more "accountable" through more rigorous, frequent, or uniform testing of students and teachers. The latter, accountability approach has so far proceeded much farther in practical politics. One reason for this is undoubtedly that the testing and accountability programs are much less threatening to teachers unions and local public school authorities, and indeed are often accompanied by large increases in public funding, as in the Bush administration's "No Child Left Behind" program. But another is that accountability is addressed directly to the problem that concerns most parents: lax teaching and discipline and poor student performance. In contrast, "school choice," especially in the form of vouchers, appears to many parents of public school students as a threat rather than an opportunity. The prospect of having to choose a school no doubt seems unfamiliar and burdensome to many parents whose main concern is that their familiar neighborhood school be a good one. And many are concerned that vouchers will make their own, public schools worse by siphoning off some of the best students and teachers, as well as financial resources. Furthermore, the prospect that some private, choice-financed schools would promote *outré* social or political views, and would tend to undermine common civic values, is worrisome to many public-spirited people.

Under the circumstances, it would be much more promising for advocates of school reform to emphasize the advantages of competition on the quality of schooling, including public schooling, rather than the advantages of choice per se. Careful studies by Caroline Hoxby and others have shown that where the degree of competition among schools is greater—because of the availability of vouchers or charter schools, because of the size and design of school districts, or because of the extent of local parochial and other private school alternatives—public as well as private schools perform better as measured by student achievement test scores.[25] The basic idea is easy to understand and consistent with intuition and everyday experience—such as that American colleges and universities, which must compete for students, are generally of much higher

25. Caroline M. Hoxby, "Does Competition Among Public Schools Benefit Students and Taxpayers?", 90 *American Economic Review* 1209 (December 2000) (this and subsequent research by Professor Hoxby are posted at post.economics.harvard.edu/ faculty/hoxby/ papers.html); Frederick M. Hess, *Revolution at the Margins: The Impact of Competition on Urban School Systems* (2002).

quality than American grade schools and high schools, which do not. Competitive schooling is more likely than monopoly schooling to deliver what most parents want. This will be so even if the range of parental "tastes" in schooling is much narrower than for groceries or music, and most parents won't have to lift a finger to reap the benefits of competitive supply: as in other markets, marginal consumers—those most inclined to search for alternatives and take their business elsewhere if they are unhappy with their current school—will drive the process for the benefit of all.

But my argument here is not only about the rhetoric but also the substance of school reform. As AEI's Frederick Hess has shown, many school choice programs, including the one inaugurated this autumn in Washington, D.C., provide choice to parents and students but not competition to schools. This is because many choice programs, formally or informally, hold public schools harmless against the departure of students for other schools—if they lose students their funding stays the same, and therefore increases on a per-student basis, or even increases in total. I daresay that a market in which, if you lose customers, your revenues stay the same or increase, is one that will be unfamiliar to many people in the business world. This is, as Hess puts it, "choice without consequence, 'competition' as soft political slogan rather than hard economic reality."[26] If the promise of market-oriented school reform is to be realized, we are going to have to shift our emphasis from the demand side to the supply side.

There are many other areas of public finance where the principle of competitive supply is likely to be more appealing than the principle of consumer choice, and for the same reason that it emphasizes the aspect of the situation of greatest interest to most people. Consider the debate over Social Security reform, where the most promising proposal is "partial privatization," which would permit workers to keep a share of their payroll taxes for investment in real financial assets. There are no doubt many people who enjoy playing the stock market, but for retirement planning most people appear to be less interested in being "free to choose" their investments than in arrangements, of whatever sort, that promise to leave them with adequate resources for their retirement years. Advocates of Social Security reform should focus not on "investment choice" (and should drop the clunky and inaccurate term "privatization") but instead on

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26. Frederick M. Hess, "Without Competition, School Choice Is Not Enough," AEI *On the Issues* (May 2004), www.aei.org/publications/filter.,pubID.20491/pub_detail.asp; *Common Sense School Reform*, chapter 3 (2004).

the long-range performance and reliability of individually owned investment portfolios provided by competing fund managers versus the current monopoly program of income transfers from workers to retirees.

The potential of competition to discipline and improve government performance exists in many other areas of national policy, and demonstrating the point has lately becoming something of a specialty of my colleagues at AEI. Joseph Antos has shown how the "Medicare+Choice" program has failed to harness the forces of competition in the provision of Medicare services—as in the case of school vouchers, choice is nice but not enough, and we should move the Medicare reform debate toward genuine competitive supply of older-age medical insurance, as in the case of Social Security reform.[27] Douglas Besharov has demonstrated how competitive supply could improve our highly dysfunctional welfare programs, from job training to rehabilitation.[28]

In every case—schooling, retirement income and medical care, and welfare services—the essential operating mechanism of reform is the voucher, but the essential political principle is competitive supply of government-specified services. That competitive supply is the crux of the matter is demonstrated by the fact that in every case the major counterproposal is competitive supply of inputs to the government rather than of outputs to citizens—public schools outsourcing classroom teaching as well as cafeteria service, the Social Security Administration investing in real financial assets rather than IOUs from the Treasury Department, Medicare contracting among competing private insurers and welfare departments among private service providers. The choice between input competition and output competition involves many issues, such as whether it is a good idea for the federal government to become a major equity owner of U.S. business firms, but the most

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27. Joseph Antos, "The Role of Market Competition in Strengthening Medicare," testimony before the Senate Select Committee on Aging, May 6, 2003, www.aei.org/news /filter.,newsID.17131/news_detail.asp; and "Can Medicare and Medicaid Promote More Efficient Health Care?", testimony before the Federal Trade Commission/Department of Justice Joint Hearings on Health Care and Competition Law and Policy, September 30, 2003, posted at www.ftc.gov/ogc/healthcarehearings/ docs/030930josephantos.pdf.

28. Douglas J. Besharov, "Creating a Marketplace for Social Welfare Services," 16 *Notre Dame Journal of Law, Ethics, & Public Policy* 519 (2002), extended version posted at www. welfareacademy.org/pubs/creating_a_marketplace.pdf.

important one concerns the tendency of competition to ferret out and reveal accurate information. Government financing of schools, Social Security, health insurance, and welfare services involves innumerable hidden subsidies of politically influential groups; typically, the direction of subsidization is far more in the direction of (a) favored provider groups and (b) middle class as opposed to poorer beneficiaries than the formal purposes and rhetoric of the programs suggest[29]—a circumstance well known to program insiders and advocates but little known to average citizens and voters. But cross-subsidies among consumers requires monopoly supply: competition extinguishes them. Although competitive supply of inputs to government agencies has the effect of reducing the agencies' program costs, competitive supply of outputs—of the programs themselves to citizens—has the further, politically profound effect of revealing for all to see the true pattern of costs and benefits otherwise embedded in program administration. Current subsidies could continue, but only if legislators were willing to embrace them openly.[30]

Competition in Ideas

The development of ideas, cultural norms and practices, and religious doctrines and faith provide both the oldest and the newest examples of the competition principle in action. Long before Justice Holmes's 1919 assertion about intellectual competition being the best test of truth, Adam Smith in *The Wealth of Nations* decried the state privileges of the Church of England for their tendency to produce doctrinal sterility and public disorder; more recently, Laurence Iannoccone and Gary Becker have noted that unbridled competition among religious faiths has contributed to innovation, variety, and growth in religious practice in the United States.[31] And, they might have added, civil peace. The dangers of religious monopoly, both secular and spiritual, are obviously at the forefront today: a central challenge is to wean Islam from the

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29. As adumbrated long ago by Aaron Director—see George J. Stigler, "Director's Law of Public Income Redistribution," 13 *Journal of Law & Economics* 1 (1970).

30. For an example of how some of the subsidies embedded in current school financing might be legislated with political transparency under a regime of school vouchers, see Caroline M. Hoxby, "Ideal Vouchers," AEI Bradley Lecture, June 4, 2001, www.aei.org/docLib/20030319_bl010604.pdf.

31. See Gary S. Becker, "Competition," in Edwin J. Feulner, Jr. (ed.), *Leadership for America: The Principles of Conservatism* 273 (2000).

belief of many leading practitioners that its truths must be advanced not by competitive persuasion but state coercion and violence.

There are many more prosaic examples of the salutary political effects of competition in ideas and knowledge. The latest brainstorm for the use of explicit information markets to improve policy is presented in a paper by Robert Hahn and Paul Tetlock released just the other week by the AEI-Brookings Joint Center for Regulatory Policy. They show how information markets could be used to vet the usually hugely exaggerated claims of EPA and other health, safety, and environmental regulators, using competition to generate real-world information on the likely benefits of new controls and the costs of achieving them, and laying the groundwork for regulatory policies based on performance rather then promises.[32]

Even in the absence of deliberately contrived information markets, a free press is an important mechanism for discovering truth and exposing falsehood in public affairs. In philosophic terms, freedom of the press is an "instrumental good" as well as an "intrinsic good." That is the implicit point of Amartya Sen's aperçu that no nation with a relatively free press has ever experienced a serious famine.[33] Consider, as an elaboration to Sen, a comparison of the SARS outbreak in China in 2002, the *Kursk* submarine failure in Russia in 2000, and the *Columbia* space shuttle failure in the United States in 2003. Each was a surprise occurrence involving great initial confusion and uncertainty concerning cause, magnitude, implications, or all three, and each involved embarrassing failures on the part of government officials and their efforts to downplay or cover mistakes. What differed was the extent of competition in the supply of information to the public and its political officials, in the form of a more or less independent media. The resulting difference in truth-discovery was four months versus four days versus four hours:

• In the case of the SARS outbreak, if China had had a competitive, independent media, news of a mysterious illness in Guangdong would almost certainly have reached Beijing within in a matter of days. As it was, four months

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32. Robert W. Hahn and Paul C. Tetlock, "Using Information Markets to Improve Policy," AEI Brookings Joint Center for Regulatory Studies, Working Paper 04-18, posted with related "policy futures" papers at www.aei-brookings.org/pages/index.php?id=36.

33. Amartya Sen, "The Point of Press Freedom," news24.com, April 30, 2004, www.news24.com/News24/World/PressFreedomDay/0,,2-10-1604_1520183,00.html.

passed, and the disease had spread to and been reported in Hong Kong, Canada, and Singapore, before the nature and extent of the problem was generally known and the Chinese government was forced to acknowledge it; by then many hundreds of people had died and the economic losses were enormous.

• In the case of the *Kursk* disaster, it took much less time—about four days—for Russia's political leaders to acknowledge the crisis and ask for help, following media reports they had failed to suppress, and only a few weeks before the true cause of the incident became generally known. While Russian officials were still speculating that the *Kursk* had been attacked by Chechen rebels, or perhaps by a rogue American sub, the Russian media, such as it was, was already homing in on the truth. That the ship's failure had been caused by an explosion of its own torpedoes was well know long before an official government commission announced that conclusion nearly two years later.

• Finally, in the case of shuttle *Columbia*'s disintegration on reentry, the fact of the disaster was known instantly and its cause was known within a few hours. Even before the shuttle's debris had been located, American television was broadcasting detailed pictures of the shuttle's launch, showing insulation breaking off the rocket launcher and smashing into the leading edge of the shuttle's wing where the breakup had begun. Almost immediately came reports that NASA officials had been aware of the problem but that no corrective or rescue steps had been attempted. By dinner time on the day of the disaster, and in the face of firm official denials, Americans already knew the essential truth of the matter that an official government commission would acknowledge many months later.

The relentless, pitiless exposure of facts that we are accustomed to in the United States depends not only on freedom of the press but on sufficient economic wealth to support an extensive network of competing sources of information and analysis. This leads many people to worry that nations that are poor and unfree, such as China, Russia, and many Arab nations, may free-ride off the Western media while concealing their own transgressions, to our serious disadvantage in international politics. The SARS and *Kursk* incidents show that there are no entirely free rides. In any event, the coming-of-age of the blogosphere is changing the equation by dramatically reducing the cost of competitive supply and its global range. The swift debunking of CBS News's use of forgeries to document claims of irregularities in President Bush's National Guard service is fraught with implications for the governments of China and Iran.

And also for our own government. My final instance of AEI agitating on behalf of the principle of competition is the criticism of my defense policy colleagues of the proposal of the 9/11 Commission to centralize control and assessment of all U.S. intelligence in a single office. One can only speculate about how harmful such a step would be in practice, given the increasing power of private intelligence gathering and analysis. In recent years, AEI scholars have several times found themselves in possession of important security-related information that the intelligence agencies either did not have or were holding back for reasons of bureaucratic politics. And when we really wanted to get the information to the top and pronto, our preferred strategy was to publish it in the newspapers! Many recent intelligence problems were the result of excessive centralization and homogenization, and the tendency of secrecy to serve as a shield against criticism and correction. These problems will get worse if intelligence is further centralized, but the increasing power of private information institutions will serve as a corrective for political officials who are paying attention—a characteristically American, competitive-market solution to the shortcomings of government organization.

During the past two decades, growing competition has swept away many powerful, long-entrenched monopolies in private markets. Now it is the turn of the most powerful and entrenched monopolies of all, the monopolies of government.

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