

Democratic Governance for a Globalized World*

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I. CONFLICTS BETWEEN GLOBALIZATION AND DEMOCRACY

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

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

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

- International cooperation via international organizations in the political, economic and financial areas (e.g. the World Trade Organization, the World Bank, the International Monetary Fund), in social affairs (UNICEF, UNESCO) or in defense (NATO), and via international treaties (e.g. the Kyoto Protocols for the global environment, or the Bologna Convention for higher education in Europe);
- regional organizations such as the European Economic Area or the European Union; and,
- on the local level, “special areas” (or, as they are aptly called in German, “*Zweckverbände*”) are designed to come to grips with the many problems transgressing existing jurisdictional boundaries.

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

Both developments result in decision processes far removed from the citizens. While they respond to the problems as seen from a technocratic perspective, they are dominated by bureaucratic considerations and by the interests of the “*classe politique*”.

Globalization therefore provokes a fundamental conflict with democracy:

Globalization creates a new geography of dynamic problems which is incompatible with the rigid boundaries of established democratic structures.

This paper discusses the consequences of this conflict and suggests ways to overcome it. Section II identifies two popular reactions to this conflict. The first idealistically wants to establish a world government, and the second relies on global markets, to solve all problems. But both ideas are seriously lacking. Section III discusses the conflict between globalization and democracy which results in a deep-seated tension between established politicians (or the “classe politique”) and ordinary citizens. One manifestation is a fundamentalist opposition against economic globalization. Another manifestation is that civic virtue on the part of both citizens and politicians tends to be crowded out. To overcome the missing flexibility of democratic governance, it is necessary to build on an open and broad model of human behavior. It must take into account that individuals are motivated by extrinsic as well as by intrinsic influences, and that there is a systematic interaction between extrinsic and intrinsic motivation, most importantly civic virtue.

Section IV advances three proposals going beyond the idealist notion of a benevolent world government, or leaving everything to markets. They all aim at making the political sphere more flexible, and to therewith make it capable of dealing with the challenges posed by dynamic globalization. The first proposal looks at the *demand* for institutional flexibility by individuals. The concept of citizenship is extended to institutions beyond states in order to provide a sense of belonging and to therewith bolster civic virtue. The second and third proposals look at the *supply* side of institutions and allow for jurisdictions to adjust to the geography of problems as well as for the international exchange of politicians. Section V discusses the relationship between the three proposal and the final section VI offers concluding remarks.

II. UNDERMINING DEMOCRACY

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

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

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

We take both conceptions to be seriously lacking. The notion of a world government tries to superimpose a power structure over existing national government without considering where the power should originate from. At best such a “world” government is the apex of the dominant world power (today the United States) which certainly does not meet the ideal of an institution fairly and equitably serving the interests of mankind. Moreover, world government will be far from democratic but due to its large distance from the citizens will exhibit strong forms of government failure¹.

The notion of a globalized world market setting its own rules is equally naive. It disregards the classical problems of market failures leading to monopolistic structures, wide ranging negative external effects (particularly with respect to the natural environment) and insufficient supply of public goods, as well as an income distribution between regions and individuals non-acceptable from most points of view.

Indeed, we presently observe heated and even violent protests against both kinds of conceptions. In particular, the United Nations financial institutions of the World Bank and IMF, as well as the World Trade Organization (WTO) have recently met stiff opposition when they held their meetings. They have partly been forced to step back from what has been interpreted to be a support of

“global capitalism”. They formally had to acknowledge the concerns formulated by vociferous interest groups supported by worldwide media attention which for various reasons oppose globalization. Such lobbying activities are, of course, a far cry from any democratic representation and they take place outside agreed (constitutional) rules.

III. TENSIONS BETWEEN POLITICIANS AND CITIZENS

Fearing the consequences of globalization, citizens have become most reluctant to grant governments the right to undertake international and intranational cooperation. They rightly feel that they have lost control over the decisions taken in the respective supra-national and inter-jurisdictional bodies. Professional politicians as well as public officials aim at shifting decisions upwards to the international and co-operational arena for exactly the opposite reason, namely that at this higher levels they are better able to pursue their goals without always having to seek their citizens' approval.

Because of the citizens' reluctance to go along with formal decision making at global, international and inter-jurisdictional levels, there is too little *formal* cooperation at those levels especially when the decisions taken by majority vote run against a member jurisdiction's interests. Hence most such decisions are taken by unanimous agreement. Decision-making in the European Union whose (implicit) constitution is far from being democratic, provides an example. Formal decision-making in the European Union will only find wide approval if the citizens are convinced that the procedures are based on democratic principles, in particular that the politicians can be made accountable for their decisions. Politicians as well as public officials prefer less visible *informal* “technical” cooperation the citizens have little, if any, chance to influence. An example are the meetings of heads of states in the European setting where sometimes far reaching decisions are channeled. The Bologna Convention

¹ See Frey (1997a) for government failures in the case of presently existing international organizations such as the United Nations or the European Union.

which has major implications for the organization of university education in Europe is another example of such “informal” decisions.

The increased importance of “technical” decisions induced by globalization has another, even more important negative consequence: Civic virtue, which is a form of intrinsic motivation, is endangered. But it has by now been well established that civic virtue with both citizens and politicians is an indispensable factor for a successful democracy².

Citizens’ civic virtue depends on their involvement in politics. Civic virtue is bolstered by having extensive participation rights in political decisions. Frey and Stutzer (2000a) empirically show that individuals derive substantial procedural utility from having political participation rights. When citizens experience that they are not involved in decisions they find important they become frustrated. This negatively affects the extent of their civic virtue. Civic virtue is also raised by institutional conditions producing a fair and equitable financial contribution to collective projects, i.e. on the extent of fiscal equivalence. As the citizens have little or no say in, as well as no direct financial responsibility for, the “technical” decisions civic virtue tends to be crowded out which further undermines democracy.

Politicians’ civic virtue depends on the obtrusiveness of the popular will. As long as the preferences of the citizens are well visible, many politicians are motivated to cater for the citizens’ interest. But when the citizens’ preferences are difficult to identify, many politicians prefer to cater for the interests of the well-organized and influential interest groups. Therefore, politicians’ motivations depend on the amount of information available about the preferences of the citizens. Another important determinant of the intrinsic motivation of politicians is the presence and absence of systematic extrinsic motivators. If politicians are regularly rewarded by specific groups, their intrinsic motivation to cater for the welfare of their constituency may be reduced. For both reasons, the civic virtue of politicians may be crowded out when decisions are taken non-democratically: democratic decisions do not only produce information about the preferences of

² See, for instance, Brennan and Hamlin (2000), or Putnam (1993)

the citizens, but also decrease the influence of direct financial relationships among politicians and interest groups.

IV. PROPOSALS

The inadequate flexibility of democratic governance faced by the globalization of many spheres of life can only be successfully addressed if the proposals advanced are based on an adequate model of human behavior. The traditional rational choice approach which has successfully been applied to many social problems (see Becker 1976, Kirchgässner 1991, Lazear 2000) is ill equipped to deal with governance issues in which intrinsic motivation plays an important role. Sure enough, the traditional homo oeconomicus model does not deny that people's behavior may be influenced by intrinsic motives such as civic virtue. But it dismisses intrinsic motivations as unimportant and fickle. Most importantly, traditional rational choice theory overlooks the systematic relationship between intrinsic and extrinsic motivation mentioned above. A more advanced model of human behavior which may be called "homo oeconomicus maturus" (Frey 1999) combines the two basically different types of motivations and explicitly accepts that they are interactive. A crucial goal of this paper is to identify the institutional conditions under which intrinsic motivation in the form of civic virtue is crowded in or crowded out.

The decision-making process dealing with issues of globalization require more flexible democratic political institutions. They must be able to adjust to the "geography of problems" instead of being bound by the traditional boundaries. The ossification of the present political system can be mitigated or even overcome by three institutional changes in democratic structures. The first one, flexible citizenship, refers to the demand side of political institutions. The second, flexible political units, and the third, flexible supply of politicians, refer to the supply side of democratic institutions. These suggestions will now be discussed in turn.

A. Flexible Citizenship

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

Three aspects of this definition have to be noted:

(a) The actors involved are the citizens and the *state*. Citizenship is a unique and monopolistic relationship between the individuals and a particular *nation*.

(b) The citizens have both *rights* and *obligations*. The rights refer to the *political* sphere, i.e. the citizens have the right to vote and to hold public office, to the *economic* sphere, i.e. the citizens have the right to become economically active as employees or employers, as well as to the *social* sphere, i.e. the citizens are protected against economic hardship within the welfare state.

(c) The *relationship* between an individual and the state goes well beyond an exchange of taxes for public services. Rather, the citizen “*owes allegiance*” to the state. The citizens are expected to be public spirited and to exhibit civic virtue. The relationship is thus partly non-functional and resorts to the intrinsic motivation of the citizens³ and to the community of people who share loyalty and identity (Eriksen and Weigard 2000). This aspect distinguishes the new type of citizenship here proposed from being purely a customer or member of an organization as theoretically analyzed in the well established Economic Theory of Clubs (Buchanan 1965)

The existing rigid concept of citizenship can be *generalized* in various dimensions:

³ These aspects are the subject of a large literature mainly in political science, see e.g. Mansbridge 1994, Fukuyama 1995, Levi 1997 or Putnam 1993, 1995. For contributions in economics, see e.g. Kelman 1987 or Frey 1997c. For law see Cooter (2000) They are also related to social trust, as discussed e.g. in psychology by Kramer and Tyler 1996.

1. *Extending national citizenship*

(a) *Temporary Citizenship.* An individual should be able to choose for a predetermined period to become a citizen of a particular political unit, for instance because he or she is working and living in a country for a specific period.

(b) *Multiple Citizenship.* For persons simultaneously working and living in various countries, a good solution might be to split up the citizenship into various parts. The rights going with the citizenship must accordingly be adjusted. In particular, the voting rights is to reflect the fact that a person chooses to split up citizenship among several nations. In the age of computers there is no problem whatsoever to allow for fractional votes.

(c) *Partial Citizenship.* An individual might be a citizen of a political unit with respect to one particular function, while being a citizen of another political unit with respect to other functions. In referenda, the voting rights should accordingly only extend to issues referring to the respective function.

2. *Citizenship in Various Types of Organizations*

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

(a) *Levels of Government.* Citizenship might refer to the level of the nation – which is the rule – but also to a lower level, such as the region, province or commune (the latter being the case in Switzerland) or to a higher level, such as the European Union.

(b) *Governmental Sub-Organizations.* Individuals might choose to become a citizen of only part of a government, such as the diplomatic service, the military or the social security administration.

(c) *Quasi-Governmental Organizations.* There are many organizations close to the public sector in which individuals might become citizens. Universities are

such an example. Indeed, the institution of “*Universitätsbürger*” (university citizen) has commonly been known in the German-speaking academic system. It obviously means much more than being an “employee” of a university. Rather, it means that one is prepared to commit oneself to the academy beyond considerations of short run purely personal benefits and costs.

(d) *Non-Governmental Organizations (NGOs)*. Citizenship may be in organizations such as churches, clubs (e.g. the Rotary Club, the Boy Scouts or even sport clubs such as Manchester United or FC Barcelona); action groups (e.g. the World Wildlife Fund, “Médecins sans Frontières” or the Red Cross), and functional organizations (e.g. ICANN, the “Internet Cooperation for Assigned Names and Numbers”). This dimension of citizenship relates directly to the concept of FOCJ discussed below. Yet another organization in which citizenship may be considered are profit-oriented firms. Citizens of firms have a special relationship, which goes beyond just being a customer or employee or stakeholder. Shareholders have a decision weight according to the number of shares, while stakeholders have no formal voting right at all but exert pressure outside of established channels, e.g. the media or demonstrations. In contrast, each citizen of a firm has a vote according to generally accepted democratic principles. While these principles differ they are not necessarily incompatible with each other. Firm citizenship can well exist jointly with shareholder rights⁴.

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

An *essential* feature of citizenship is that an organization can expect a measure of allegiance and loyalty from its members. Citizens are prepared to abstain

⁴ Two voting principles can well co-exist. This has been demonstrated by the formal co-determination rights, as they exist in Germany. In that country, in companies exceeding 2,000 employees, the shareholders and the representatives of the

from exploiting all short-term advantages. “Citizenship” means that the members exhibit an *intrinsically based motivation* to support “their” organization over and above purely egoistic calculations. This also means that citizens are prepared to co-operate in the provision of public goods even when pure egoists would try to free ride.

B. Flexible Political Units

The political jurisdictions should extend according to the needs of the various functions of government. These needs differ according to the particular function to be cared for. As a result, the political units generally overlap; a particular geographical area is served by various political suppliers of governmental goods and services. In order to safeguard that these units serve the interests of the citizens, they are to be democratically controlled, and the individuals must be able to enter and exit thus establishing interjurisdictional competition. This concept has been called FOCJ, following the initials of its constitutive characteristics: Functional, Overlapping, Competing Jurisdictions⁵.

Based on the traditional analysis of (local) public goods and external effects it could be argued that in FOCJ the citizens will resort to free riding. Thus, for example, citizens without children will give up membership in FOCJ devoted to the supply of school services and save the corresponding tax cost. They disregard the interests of the citizens with children though they enjoy the positive external effects of a good school education. The competition between the jurisdictions is thus predicted to lead to a so-called “race to the bottom” resulting in under-provision of public goods, and in the extreme to a complete breakdown of public supply.

This criticism assumes that individuals exploit all opportunities to free ride. But it is mistaken to assume that individuals take fully advantage of every opportunity

employees hold the same number of seats in the Aufsichtsrat, the main decision-making body. This arrangement seems to have worked reasonably well.

to profit at the cost of others. Most people under many conditions do not behave in a purely egoistic way.

Over the last years theoretical and empirical research has mustered strong and cumulative empirical evidence that under many conditions individuals are prepared to contribute substantially to what they consider the common good even if it is not in their individual egoistic interest to do so. Free riding in the presence of public goods (as analyzed by Olson 1965) remains a serious problem especially when people feel that others do not contribute their fair share, or when the situation is purely anonymous and the possible gain is all too large. But very extensive field studies (see, in particular Ostrom 1990, 2000, Ostrom, Gardner and Walker 1994) confirm that these incentives to free ride need not dictate behavior especially when the persons know, and communicate with, each other. There is similar evidence from a large number of carefully controlled laboratory experiments. No less than 40 to 60 percent of subjects in a one-shot public good situation contribute to the provision of a pure public good. The level of co-operation remains between 30 and 50 percent of what would be socially optimal even after many repetitions wherein the subjects could easily learn to take advantage of each other (e.g. Dawes, McTavish and Shaklee 1977, Ledyard 1995, Bohnet and Frey 1997, 1999). Individuals do have a measure of intrinsic values and corresponding *intrinsic motivation* (e.g. Deci 1971) which differs from extrinsic motivation induced by relative price variations.

These insights link up with the rapidly growing research pointing out the importance of social capital for individuals' behaviour in the political and general social setting (Putnam 1993, Coleman 1990). There is now a wide consensus among social scientists that intrinsic motivation, loyalty, or social capital, is an indispensable resource for a well functioning society⁶. When it is insufficiently developed, or scarcely exists, society threatens to break down or at least functions at a low level of efficiency. Thus care must be taken to protect it. It

⁵ See, more fully, Frey and Eichenberger 1996, 1999, and the critical discussion by Vanberg 2000 and Blatter and Ingram 2000.

has indeed been shown in experimental (Deci and Ryan 1985, Deci, Koestner and Ryan 1999) as well as in field research (Frey 1997b, Frey and Jegen 2000) that external interventions which are taken to be controlling by the persons affected may crowd out intrinsic motivation. In contrast, external interventions which are perceived to be supportive tend to crowd in intrinsic motivation.

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

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

FOCJ can be designed to meet these tasks. The term "functional" should be interpreted in a broad, and non-technocratic way. The functions along which the jurisdictions should extend should be designed such that the citizens involvement and commitment for specific public activities are strengthened.

⁶ One may add that this also holds for relationships within firms, see Osterloh and Frey

Thus, for example, citizens' intrinsic motivation to protect the natural environment should be reflected in jurisdictions caring to these preferences. Similarly, FOCJ should be designed to fulfil citizens' conceptions of fairness.

The flexible political institutions in the form of FOCJ are well capable to support directed civic virtue:

- Citizens are offered the possibility of getting democratically involved in, and becoming financially responsible, for political institutions catering for particular issues, for example the natural environment or social work. They therewith experience a sense of belonging which is more difficult, if not impossible, to get in traditional democratic governmental institutions catering to many diverse functions or in technocratic inter-governmental cooperation units without either democratic institutions or tax autonomy.
- FOCJ are designed to extend over the geographic area in which the beneficiaries of the respective public supply live. Both positive and negative spillovers are thereby minimized which means that the citizens contributing to its finance can be certain of not being exploited by others. The crucial requirement that free-riders are prevented is better fulfilled in FOCJ than in traditional, all purpose political units.

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

(a) *Politicians*. An important supporting determinant of intrinsic motivation is a reliable feedback for one's actions (Frey 1997b). But in all-purpose governments politicians often do not know the citizens' desires among the great number of dimensions they are supposed to influence. In most circumstances, politicians are only exposed to the demands by interest groups. As FOCJ concentrate on one function, and the citizens have the possibility to express

their views in referenda, the politicians experience direct reactions to their decisions which helps to raise their civic mindedness.

(b) *Citizens*. The more extensive the scope for co-determination, and the more seriously their concerns are taken in the political process, the higher tends to be citizens' involvement.

Both in the case of politicians and citizens the emergence of FOCJ in response to individuals' preferences has another beneficial effect on the willingness to cooperate in the supply of public goods. FOCJ induce them to consider reasonable and credible alternatives to the existing situation. Both of them focus on policy content instead of general, non-issue directed ideologies. Collecting and evaluating information about the alternatives generates a private benefit because it allows each individual to select the most appropriate jurisdiction to participate in. Exit and voice are in this case positively related, i.e. easing exit is no substitute but rather a complement to voice⁷.

C. Flexible Supply of Politicians

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

- Protectionist regulations: Almost everywhere, only nationals are allowed to run for political offices. Moreover, the candidates often have to live in their precinct.
- Regulations of the "production process" of politics: Usually only individuals can run for office. Parties, are not allowed to do so, but have to nominate individuals as candidates. Moreover, parties must be non-profit organizations, and their internal structure is heavily regulated. At the same time, parties have some kind of a political monopoly, as Non-Governmental-Organizations and firms cannot become political suppliers.

⁷ Originally, Hirschman (1970) suggested a negative relationship but later admitted the possibility that raising the possibility to exit may also raise voice (Hirschman 1993).

- Regulations of the "prices of politics": all the explicit prices for political services, i.e. the pay of representatives and the government subsidies for parties, are fixed by law.

These regulations weaken political competition and should therefore be abolished. Deregulation of politics benefits the citizens in a similar way as deregulation of consumer markets benefits the consumers. It strengthens the influence of the weakly organized social groups, and it enhances efficiency in all fields of politics.

The political market can be deregulated and made more flexible in various ways (for a broader account of the effects of political deregulation see Eichenberger 2000):

(a) Decreasing protectionist barriers by allowing foreigners to supply political services. Foreigners and non-residents are allowed to run for all offices. The effect of this deregulatory step is quite similar to the economic effects of free trade. It increases the supply of candidates and, thus, the competitive pressure which also makes domestic producers more efficient. The incentives of the politicians to stick to their promises increase. Honesty and success in one country increase credibility and, thus, the chances of being elected in other countries. This makes it profitable to a supplier to build up an international reputation to be a high quality and credible policy producer.

(b) Deregulation of the production process. Parties and firms are allowed to directly run for political office, without nominating a specific individual (but, of course, individuals are still allowed to run as candidates). If such a firm is elected, it can delegate whomever it likes to fulfil a task related to its mandate, i.e. it can also substitute new delegates for hitherto active ones. This deregulatory step allows domestic and foreign policy suppliers to stick more closely to their promises. Therefore, the credibility of campaign promises is increased. The market is opened for internationally active policy suppliers whose success depends on the professional competence of the organization as a whole rather than on the individual celebrity of their exponents. Thus, internationally reputed private organizations can directly step into politics, be

they well-known consulting firms or human rights watch and environmentalist organizations.

(c) Deregulation of the prices for political services. The explicit revenues of politicians are increased, or even set by a market mechanisms. Increasing explicit revenues crowds out implicit revenues and, thus, decreases the asymmetry among interest groups. The influence of the weakly-organized groups increases. Moreover, the market is opened for profit-seeking firms which are more dependent on explicit income than traditional policy suppliers.

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

Reforms in the interest of citizens but which are not in the interest of the "classe politique" become more likely. An instance are constitutional reforms strengthening the influence of the citizens, e.g., federalism and direct democracy (see Frey and Stutzer 2000b, Kirchgässner, Feld and Savioz 1999, Eichenberger 1999). In a politically closed country political parties most often do not follow their promises to strengthen these institutions, because such reforms are against their interests as soon as they are part of the majority.

Increasing explicit revenues of politicians crowds out implicit revenues. Various mechanisms contribute to this result: First, explicit compensations are paid by the state. As the citizens decide on the allocation of these compensations with their vote, their political influence increases. Second, the suppliers have to build up an international reputation of not relying on explicit reputation. Third, higher explicit compensations strengthen the incentives of new firms to enter the market and to specialize in explicit instead of implicit compensations. Moreover,

profit-seeking policy suppliers depend more strongly on explicit compensations than traditional parties. Fourth, high explicit compensations have an effect similar to efficiency wages. When explicit compensations increase, losing the job becomes more expensive. Thus, politicians try to stay in government, i.e. they are willing to adapt their policy towards the citizens' preferences. Thus, it is well known that higher salaries of bureaucrats crowd out corruption (see, e.g., World Bank Development Report 1997). Finally, many implicit income payments are at the limit of legality. In an open market, however, there are more competitors and thus a larger probability that firms are attacked when they get high implicit revenues.

Political deregulation strengthens civic virtue. The increase in explicit compensations makes politicians less dependent on well-organized interest groups and allows them to focus on the citizens' demands, i.e. increases their self-determination, which has been identified as a main determinant of civic virtue (Frey and Jegen 2000). Although higher explicit compensations as extrinsic motivators may sometimes interfere with civic virtue, their effect has to be compared with the one of implicit compensations which is much more destructive. At the same time, globalization of the political market opens the political process to the highly and often intrinsically motivated members of Non-Governmental-Organizations. Finally, in deregulated political markets, institutions which strengthen civic virtue (e.g., direct democracy and federalism) have much better chances to be effectively implemented.

V. RELATIONSHIP OF THE PROPOSALS

The three proposals for raising the flexibility of democratic institutions in order to enable them to cope with globalization emphasize different aspects but they are also complementary. The proposals directed at the supply side of institutions, the establishment of FOCJ and opening political markets to international competition, are efficiency oriented. They focus on the favorable consequences of competition on extrinsic incentives.

As has been discussed at length in the subsection devoted to *functional jurisdictions (FOCJ)*, the supply of public goods in such jurisdiction is unlikely to lead to cumulative free-riding behavior. The way FOCJ are constructed supports “directed” civic virtue. The individuals active in such a jurisdiction are to a considerable extent prepared to enter a “quasi-voluntary” contract: They freely decide to let themselves be bound by the rules of the chosen jurisdiction. In addition to paying the taxes considered to be fair to support the public goods supplied they are prepared to remain in the political unit as long as the conditions meet their expectations, in particular as long as they are not taken to be intolerable.

The generalized concept of *citizenship* developed strengthens these tendencies. The incentives to free ride are reduced because citizenship establishes a bond between individuals and “their” political community. As has been stressed, by its very nature citizenship not only involves rights but also obligations. Some of the obligations are formally laid down, but possibly the more important ones are at the moral level. They induce the individuals who can freely choose in which organization or organizations to become a citizen to abide more strongly to the rules than they otherwise would, and to become more immune to the temptation to free ride. This does, of course, not mean that individuals as citizens completely change their behavior and never exploit any possibility to reap a short run gain at the expense of other citizens. But it means that they do so less, and in particular that they are more prepared to provide second level public goods in the form of sanctioning other citizens who violate the rules, and who exhibit no sense of obligation towards their political community.

The *international exchange of political suppliers* in an indirect way also contributes to bolstering civic virtue, and thus to restrain free riding temptations. Allowing foreign politicians to compete with local politicians brings about a public supply at lower cost and more closely geared to the preferences of the population. The citizens are more satisfied with public supply which tends to raise civic virtue.

These considerations show that while the three proposals focus on quite different aspects of democratic governance, they are complementary to each other.

VI. CONCLUDING REMARKS

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

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

Putting any of these three proposals for institutional flexibility into reality would reduce the extent to which globalization undermines democracy. Thus each proposal could be introduced in isolation. But it has also been shown that they are in important respects complementary. In particular, their interaction serves to reduce free-riding temptations arising with public goods supply by bolstering civic virtue.

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