
On Regime Uncertainty and Legal Entrepreneurship

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According to economic historian Robert Higgs (1997), an important reason why the Great Depression lasted as long as it did was the prevalence of what he terms “regime uncertainty”—that is, the kind of uncertainty that businesspeople, investors, and entrepreneurs feel in a political and legal environment that threatens to tax and regulate their wealth-generating activities to the extent that they can in many cases no longer expect these activities to be profitable. In other words, the problem is not the uncertainty produced by unpredictable consumer behavior or natural phenomena, but the uncertainty that politicians and bureaucrats create.

However, insofar as the ability to forecast uncertain future accurately can be seen as the main source of entrepreneurial profits (Shackle 1958, 1968; Mises [1949] 1966; Salerno 2008),¹ we may wonder why the emergence of regime uncertainty should be viewed as an especially destructive deterrent to entrepreneurship rather than as an obstacle that entrepreneurs should be uniquely suited to deal with.

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1. Successful entrepreneurship is such a comparatively rare phenomenon because it involves dealing not only with risk (that is, measurable and statistically predictable “uncertainty,” against which one can insure), but also with “real uncertainty,” which characterizes areas of knowledge in which there are no constants and no experimentally separable variables. The prime example is the area of human action. For more on the distinction between risk and uncertainty as well as on the corresponding kinds of probability, see Mises [1949] 1966, 105–18; Knight [1921] 1985; and Hoppe 2007.

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The only satisfactory response to this question is one that makes a meaningful distinction between regime uncertainty and its “standard” market counterpart.² It would be difficult to think of the former as simply a particularly intense and overwhelming degree of the latter because doing so would suggest that the conditions of regime uncertainty simply make the standards of successful entrepreneurship more exacting, which is inconsistent with the fact that such conditions adversely affect the activities of all entrepreneurs, not only the supposedly insufficiently competent ones. It would likewise be difficult to regard regime uncertainty as qualitatively different from its more familiar counterpart in the sense that it cannot be successfully borne by even the most acute entrepreneur because then the emergence of the phenomenon in question would completely eradicate rather than severely reduce the scale and scope of business activities.

Hence, the most promising answer in this context seems to be that regime uncertainty is not qualitatively different from “ordinary” market uncertainty, but it operates on a different level, which is normally removed from the ambit of entrepreneurial decision making. In order to illustrate this claim, I refer to the hierarchy of levels of social analysis proposed by Oliver Williamson (2000). In this hierarchy, the first level is occupied by soft institutions—customs, traditions, norms, and religions—which emerge largely spontaneously and develop in an evolutionary manner, thus changing very slowly and allowing comparatively little scope for everyday uncertainty understood in the way discussed earlier. On the second level are hard institutions, whose purpose is to specify “the formal rules of the game” (Williamson 2000, 597), such as property rights, contract law, and so forth. The third level relates to the “play of the game,” especially to “aligning governance structures with transactions” (Williamson 2000, 597)—that is, to the ways in which entrepreneurs give their firms and projects an appropriate organizational structure. Finally, the fourth level deals with the strict essence of entrepreneurial activity, aligning the existing and future supply of consumer and producer goods of various orders as well as the existing and future technological possibilities with ever-changing consumer preferences.

The crucial point here is that entrepreneurship operates on levels three and four, which are composed almost exclusively of variables, but not on levels one and two, which are supposed to provide the underlying framework of constants. In other words, the content of particular contracts that any given entrepreneur concludes and the types of property that he purchases or sells during his daily activities can be—and usually are—in constant flux, but the nature of the underlying contract law and property rights has to be sufficiently fixed or at least predictable if the entrepreneur is to have any chance to conduct such activities profitably. Regime uncertainty prevents such fixity or predictability from prevailing, and because it originates on level two of

2. For an extended analysis of the relationship between regime uncertainty and “regular” market uncertainty, see Bylund and McCaffrey 2012.

the hierarchy, which typically lies outside of the scope of entrepreneurial decision making, entrepreneurs qua entrepreneurs can do little to overcome this predicament. The only solution available to them under a system of coercive, centralized lawmaking is to infiltrate the realm of politics, either passively by placing their informants in the appropriate legislative and judicial bureaus or actively by influencing the decisions the bureaus make. This strategy, however, is feasible only for the representatives of big business and is particularly likely to engender favoritism and other unhealthy phenomena characteristic of the overlap between business and politics, known under the umbrella term *political entrepreneurship* (Kolko 1963; DiLorenzo 1986, 1996; McCaffrey and Salerno 2011).

However, under a contractual, polycentric legal order, the notion of regime uncertainty, as defined on the basis of Williamson's hierarchy, does not retain any logical meaning. Under such an order, the establishment and maintenance of the requisite legal framework and the corresponding "rules of the game" lie in the domain of market entrepreneurs, thus eliminating any qualitative difference between the uncertainty associated with the second level of the hierarchy and that associated with its third and fourth level. For the incentive reasons considered in the standard literature on the subject (Tannehill and Tannehill 1970; Rothbard 1973; Molinari [1849] 1977; Friedman [1973] 1989), it is unlikely that the arrangements in question would allow for the appearance of arbitration and protection agencies that would actively try to hamper entrepreneurship by coercively meddling with business projects that involve no initiation of aggression against nonaggressors. In all probability, such institutions would quickly meet with widespread ostracism, retaliatory actions by nonaggressive protection agencies, and condemnatory verdicts by reputable arbitrators, which would swiftly drive them into bankruptcy.

Moreover, if at any given point the existing arbitration agencies became whimsical and unpredictable so that their services were useless in settling disputes among litigants in a mutually satisfactory manner, the element of synchronic competition built into the system under consideration would immediately trigger the market process to weed out the incompetent ("uncertain") arbitrators and replace them with more trustworthy and skillful ones.

Finally, if in this context one were to worry that polycentric law would have to be fragmented, chaotic, and internally conflicted because of a potentially large number of competing agencies being responsible for its oversight (thus necessarily creating rather than preventing the emergence of regime uncertainty), one needs to remember that all of those agencies would have an interest in making the general rules they professed to uphold sufficiently uniform to reflect accurately the shared values and expectations of the society they purported to serve (Boettke, Coyne, and Leeson 2008). At the same time, however, one must bear in mind that within this general framework of shared social values and expectations they would have to adjust their verdicts to the specific circumstances of time and place of any given case as well as to the fundamental principles of logic and commonsense prudence. Hence, polycentric

law would in all likelihood constitute a combination of macroscale fixity and micro-scale flexibility.

Thus, in a competitive legal context, legal entrepreneurship turns out to be a realistic and decisive safeguard against the emergence of regime uncertainty.

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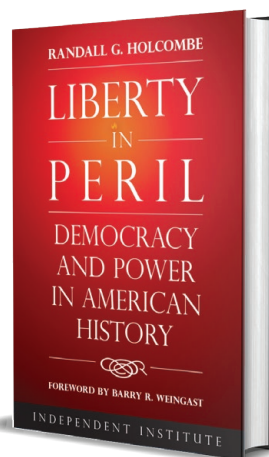
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