World Regulations and Harmonization

PASCAL SALIN

The analysis of world regulations and harmonization is a challenge for someone who does not—as I do not—accept regulations or believe in so-called public goods. However, we have to concede that it is increasingly accepted that globalization needs a counterbalancing power in increased worldwide regulations and harmonization. Most people have now accepted both trade liberalization and deregulation on a national basis. They have noticed that trade liberalization is beneficial as far as consumers can get a larger range of choice and lower prices. However, many object to the assumed perverse effect on employment, low-income workers being supposed to suffer from the competition of workers from less-developed countries. The reduction of regulations limiting competition inside a country has obviously contributed to more competition between national producers, but people are often opposed to more competition from outside. Meanwhile, the development of the Internet and the growth of e-business contribute to the acceptance of a worldwide perspective and to the awareness that markets are international. Therefore, the "globalization" of activities is increasingly felt as a fact of life against which it would be unrealistic to fight, although nostalgia for protectionism and state regulations exists everywhere. Still, most people also feel that we should minimize or suppress the assumed perverse effects of deregulation and world competition by means of world harmonization and regulations.

According to mainstream thinking, in order to avoid anarchy, global rules must be substituted for the previous scattered regulations, which, because of their national character, are considered unsustainable. Because economic problems have become worldwide problems, they must be solved directly at the global level. The argument

Pascal Salin is a professor of economics at the Université Paris-Dauphine.

The Independent Review, v.VI, n.1, Summer 2001, ISSN 1086-1653, Copyright © 2001, pp. 59–80.

for global policies also stems from the idea that certain desirable policies cannot be fully effective insofar as they are undertaken at the national level. Two main obstacles are perceived:

- First, spillover effects would occur so that the result of a particular policy in one country would depend not only on its own implementation, but also on the design of policies made by other countries. To reach an "optimum situation," governments would have to coordinate their policies so as to minimize negative externalities and maximize positive externalities.
- Second, certain public goods or public bads, by their very nature, are produced at the world level. An obvious example would be atmospheric pollution.

My tasks in this article are to discover any apparently acceptable argument in this dominant economic approach, notwithstanding my initial doubt that any such argument exists, and to identify the best counterarguments we might use to explain the main errors of the mainstream view.

Differentiation and Homogenization

> One fears diversity, one stigmatizes it under the name of anarchy; but it is necessarily the outcome of the very diversity of intelligent minds and convictions, a diversity which furthermore tends to be erased by discussion, study and experience.
>
> **—Frédéric Bastiat,** ***Justice et Fraternité***

We ought to meditate on this beautiful argument of Frédéric Bastiat in favor of diversity and ponder his trust in the ability of free human beings to converge progressively toward the common discovery of true knowledge, especially at a time such as ours when efforts are constantly being made to standardize human situations by compulsion. In fact, "unity in diversity" could be considered a major characteristic of humanity: unity because human nature has certain universal features, implying in particular that humans are rational, which means that any human action is directed by the use of reason; and diversity because any human being is concretely different from any other and even aims at differentiating himself or herself from others. Indeed, this concrete diversity is what makes exchange possible and profitable, so that a human society can be defined as an exchange society. These very facts of human nature imply that there is necessarily a tension between the need for unity and the need for diversity. In a sense, we might say that one of the main problems human beings have to solve is finding an optimal combination of homogenizing (because they share the same human nature) and diversifying (because they are different and have different aims and knowledge). To what extent rules or activities ought to be harmonized, who chooses the optimal degree of differentiation (and therefore of homogenization), what are the best processes to find the limits—these are some of the problems that necessarily must be solved. From what I have already stated, it seems obvious that we cannot accept as valid the statement that homogenizing is always profitable (seemingly the motto in Europe).

To be sure, a few general rules can be considered universal—for example, the principle that one ought to respect another's life and property or the principle that "the contract is the law of the contracting parties." As far as these principles are considered universal, they are identical for all individuals, and there is no room for any diversification of principles. It is certainly true that some people do not believe in these principles or even do not believe that universal principles may exist. However, insofar as one considers that these principles are inherent in human nature, it would be inconsistent to admit that they are not valid for all individuals. Clearly, they need not be harmonized: it is their very nature to be universal, and they are recognized as such, so no explicit act of will is necessary to make them universal. Moreover, no worldwide regulations have to be adopted in order to enforce them—they are recognized, or they are not.

Now, we may consider that—apart from such universal principles, which by definition are common to the whole of humankind—all human activities are specific, reflecting the concrete diversity of human beings. Therefore, we can assume from the start that diversification is normal and even desirable. From this point of view, the present fashionable push toward harmonization seems to rest on a misunderstanding of the real behavior of individuals. If we accept the view that differentiation is the basic reality, we then have to wonder about the extent to which and the criteria according to which any homogenization or harmonization is justified.

In brief, two diverging views of social processes may underlie any precise social or economic theory. Collectivists view individuals as mere parts of a broader society and disparage their individual specifics, whereas individualists emphasize those specifics. Consider an example, the problem of competition (and, therefore, the problem of monopolies and cartels). The mainstream theory—the theory of pure and perfect competition—suits the prejudices of those economists who belong to the first stream of thought, the collectivist one. It is assumed that competition prevails whenever a great number of firms produce exactly the same good under the same conditions. In fact, this approach is technological and not economic because it focuses on purely technical characteristics: it is assumed that for any commodity there exists one optimal technique available to all producers. Competition, thus defined, is supposed to determine an "optimal" outcome (in the sense that it is impossible to improve the satisfaction of anyone without decreasing that of someone else). Economists from the individualistic stream—mainly Austrian school economists—consider that competition prevails whenever there is free entry and producers are free to discover the best techniques and the best forms of organization. From this point of view, the great merit of competition stems from its inducing each producer to *differentiate* itself from the others. In other words, the first school believes in the harmonization of economic activities, the second in their differentiation.

Being convinced that the traditional theory of pure and perfect competition is fundamentally wrong, we are left with the idea that it is optimal to have the highest possible degree of differentiation in all activities, so that our initial question can be reformulated: Are there exceptions to the general case, implying that in some situations a process of harmonization can be profitable?

In fact, many specific activities exist in which gains can be obtained from decreasing differentiation. The reasons can be found either on the supply side or on the demand side. On the supply side, such situations occur especially in network activities, such as telecommunications, transportation, and money production—activities frequently considered public utilities per se or even natural monopolies. In particular, whenever there are externalities or economies of scale or economies of scope, one can obtain gains by coordinating several producers or by substituting a single producer for a number of them. On the demand side, there are costs of diversification because demanders have to bear search costs of information in order to know the specific characteristics of each good and the extent to which those characteristics meet their particular needs. Information costs are therefore decreased by the introduction of standards and labels.

Some may consider, as governments frequently do, that the best way to meet the alleged need for homogenization is to replace a number of producers by a single one—a legal monopolist—who can both extract gains from producing at the optimal technological level (exploiting economies of scale) and decrease information costs for consumers, the total gain supposedly being shared by producers and demanders. But another solution consists of maintaining a diversity of producers who invent some means to obtain coordination gains—a "cartel solution." In fact, a cartel can be defined as a productive structure in which different producers make their products perfectly substitutable. They produce homogeneous goods, which means that they harmonize their productions. In that sense, cartels do not deserve the usual negative reactions they arouse. They are efficient ways to meet a specific need for homogeneity.[1] With free entry into a market, the existence of cartels does not imply that producers have organized themselves in order to exploit demanders (because free entry would necessarily induce an outsider to compete with them); it is a rational way to meet a specific need for harmonization.

For example, in the case of money production, there are economies of scale and therefore decreasing marginal costs because, among other things, the costs of advertising the characteristics of a currency may be more or less fixed and the centralization

1. See Salin 1996. The three following paragraphs are adapted from this article.

of reserves allows savings of resources; there are also economies of scope because information acquired by a financial intermediary can be efficiently used to create money against credit; and, finally, there may be externalities because a currency is more useful for one person the more widely it is used by others. Even if one disagrees about the precise reasons for homogenization, anyone may accept the idea that it would not be optimal to have a very large number of different currencies.

Governments and all the "experts" who support them usually shift from such observations to the conclusion that natural monopolies exist so that public monopolies or regulations are necessary in order to avoid the exploitation of demanders by producers. In fact, only one conclusion may be drawn from such observations—namely, that a gain might be obtained from decreasing the degree of differentiation in the production of such goods, substituting one or a limited number of goods for a greater diversity. However, it does not follow that the optimal degree of diversification—or, conversely, the optimal degree of homogenization—can be decided a priori by means of a purely technical approach.

The fact that, in many activities, gains from harmonization can be obtained does not imply that governments have to impose harmonization. In fact, we cannot know in advance and forever whether such gains exist in any activity and if so how great they are. That knowledge has to be *discovered*. As is well known, competition—that is, free entry—is the most effective means of discovering the best processes and therefore of discovering the extent to which homogeneity gains exist and whether they persist or change over time. More specifically, it cannot be generally said that homogeneity gains exist in a certain activity because they may exist at a given time and at one precise point of the production process but not forever and throughout it. For example, in a telecommunication or transportation network, it may not be efficient to have more than one major highway in some part of the network, whereas in other parts no economies of scale exist; the highway may be operated by a "monopolist" or by several producers coordinated into a cartel, whereas the other parts may be managed by different, uncoordinated, producers as well as by a cartel (perhaps the one managing the highway). As new technologies are discovered, the place and role of the cartel may change over time.

Thus, we can certainly accept the idea that a maximum differentiation of goods and activities is not necessarily the preferred scheme; for a given activity at a given time, gains may be obtained from homogenization, which is to say from a perfect substitutability between goods (even if produced by different firms). Obviously, it would not be optimal for each individual to use his own units of measurement or for a great number of telephone networks to coexist. In such cases, a higher degree of homogeneity would be profitable for both producers and consumers. But *marginal* gains are not always positive, so that the optimal dimension of such activities need not be that in which the same goods are produced all over the world by a single producer or by a global cartel producing perfectly substitutable goods—a single world currency, a single world language, a single telephone network, and so forth.

Those who believe in the necessity of such harmonization share a technological view of production instead of a human (or praxeological) view. They believe that it is possible to define optimality (an optimal dimension, an optimal organization) without any reference to individual minds. But economists know (or ought to know) that optimality is meaningless if it is defined independent of individual wants and perceptions. Each individual, as a consumer or as a producer, has his own view of the optimal degree of differentiation (and, therefore, of homogenization) for the various services he may desire. For example, some consumers may desire to buy a car offering only basic transportation services, whereas others prefer to have a very broad spectrum of choice. Some producers choose a strategy of differentiation (for instance, Apple in the computer industry), and others a strategy of homogenization. It is senseless to suppose on the basis of purely technical considerations that it would be optimal to have only a certain number of car models in the world or a single standard for computers. Given that the optimal degree of differentiation varies among consumers and producers, not everyone can obtain exactly the degree of differentiation he would prefer and therefore a maximum degree of satisfaction. It is the role of the market to adjust the diverging wants of market participants about differentiation.

To sum up, for any activity there is an optimal degree of differentiation (and hence of homogenization), but we cannot know a priori what it is and how it changes over time with changes in the wants and perceptions of consumers, in production techniques, and in producers' strategies. We have to discover this (changing) optimal degree of differentiation, and the best way to discover it is obviously by means of competition, the free entry of producers into markets.

In contrast, those who take a technical approach to the problem assume that they do have enough knowledge to identify the optimal degree of differentiation. If ever that optimal degree is not reached by the spontaneous working of the market, they consider themselves justified in harmonizing the characteristics of produced goods in order to increase the efficiency of production and bring a higher degree of satisfaction to consumers. On the basis of such a view, many people favor world (or at least regional) harmonization through some constructivist process. They suppose that it would be more "efficient" to have a single world currency, a single world language, or a single world legal system.

Conceivably, in some cases, worldwide homogenization would be the spontaneous end result of the market process, but we cannot know in advance. Given a free market, if such worldwide homogenization does not occur, then it is not optimal. Let us consider the oft-used example of using language to communicate, typically a network activity. Clearly, if everyone used a different language, each of the languages would be perfectly useless. We gain by diminishing the degree of language differentiation. If one assumes that the marginal gain is always positive, one may conclude that a single world language would be optimal. But such linguistic convergence has not happened over the whole history of humankind. To be sure, languages have not always been free of state interference, and the authorities have frequently forced their citizens to use a so-called national language. Nonetheless, language is certainly a domain in which competition has prevailed. Although a constructivist would consider it more efficient to have a single world language, we nevertheless have a great diversity. More precisely, there is emerging a common world language—English—alongside many local or regional languages (which often incorporate Anglicisms). Languages play different roles, and according to specific needs the same person may use one or another. World language harmonization would require imposing a single language for all uses, either an existing one (such as English) or a fiat language (such as Esperanto). Similarly, mainstream opinions exist because people find it rewarding to use the opinions of others instead of bearing the costs of developing personal opinions.

National Dimensions and Their Distorting Effects

The present world is composed of nation-states. Each can be defined as a territory on which the state benefits by acting as a monopolist of legal constraint. The state—more precisely, the leaders of the state—decides that it will be the sole producer of certain goods (defense, money, transportation, electricity, and so forth) and that it will exercise the power to regulate other activities. Ad hoc theories regarding public goods, natural monopolies, and so on support such a pretense by giving it an apparent scientific justification. By definition, the activities carried on solely by the state monopoly are harmonized because no one else is allowed to compete in those lines and to introduce some differentiation. Moreover, regulations tend to impose common standards on private activities. For example, French firms are required to use the official accounting techniques, although they would prefer American rules. (Therefore, some of them use both systems.)

As previously stressed, coordination gains can be realized in many activities; hence, there is an optimal degree of homogenization or an optimal productive area. But the existence of nations makes it difficult to reach the optimal dimension in each activity for three main reasons:

- First, the optimal dimension of the productive area varies among activities, so the existing dimension of a nation can hardly be expected to coincide with the optimal dimension for any activity . It may be too large or too small. The theory of natural monopoly rests on the idea that marginal costs are steadily decreasing for certain activities, perhaps because of network effects. It is therefore assumed that only one producer can survive and that competition (in the traditional sense of the coexistence of several producers) would be wasteful. In order to avoid a social loss from suboptimal production, the state has to exercise such an activity. Among the many criticisms we might make of this theory, one is relevant for the

present discussion: How can it be possible that the optimal production area for, say, telephone or electricity distribution might be the United States in one case but Zimbabwe in another? The dimension of a nation is arbitrary, is a legacy from the past, and has no theoretical—and therefore no practical—justification.
- Second, when speaking of the optimal dimension or the optimal scale of production in any activity, we do not refer necessarily to any territorial dimension, but only to the set of producers and consumers and the number of units produced all over the world. An optimal monetary area, for example, contrary to the traditional theory, may have no territorial dimension at all. It might simply comprise the set of transactions that are using a given currency.[2] Again, therefore, the optimal area for many activities may not coincide with the borders of any nation.
- Third, as previously emphasized, the optimal dimension of any activity needs to be discovered, and the best way to discover it is to allow competition to occur. Meanwhile, competition induces people to devise new technologies and new institutional arrangements so that the optimal dimension is changing over time. Territorial legal monopoly hampers innovation, making it impossible to find the optimal degrees of differentiation and homogenization.

All this implies that it is meaningless to try to define an optimal dimension of nations insofar as they are viewed as territories in which some harmonization has been obtained for a number of different activities. If one embraces the now traditional definition of the nation as a nation-state performing many different activities in a given territory, the dimension of such a nation cannot be optimal. Searching for an optimal dimension of nations would more readily be seen as meaningless if one gave, as one ought to give, a purely subjective meaning to the concept of nation—namely, a set of individuals who share a common feeling of belonging to the same culture and sharing the same traditions and language, so that each person determines for himself which nation he belongs to—for instance, the Provençal nation, the French nation, the French-speaking nation, the European nation.

There is no justification for the current process of political integration—the enlargement and consolidation of state monopolies. This process is the opposite of economic integration, which is properly understood not as the merging of nation-states that have nationalized many activities and developed a regulatory power over citizens, but as the removal of obstacles to exchange and hence the facilitation of greater competition. The argument in favor of world economic integration with free entry of producers and consumers in markets—global free trade—cannot be disputed; it stems from a purely logical argument derived from the universal principle that trade

2. The optimum monetary area in the theory developed by Robert Mundell is territorially based on the assumed "optimal" adjustment obtained from the use of various policy instruments. I have proposed another—nonterritorial—definition of the optimum monetary area in a paper presented to the Mont Pèlerin Society; see Salin 1988.

benefits both parties to a voluntary exchange. In stark contrast, there is no theoretical justification for political integration. That sort of integration is the outcome of political power games. World competition is preferable to regional political integration, such as the European Union (EU).

From this point of view, we can see that a dramatic and not wholly accidental confusion in concepts has arisen. So-called economic integration is usually interpreted as consisting of the merging of several nations to create a supernation, as if we could take for granted that it would be optimal to increase the present dimension of nation-states. In fact, any system can be considered to be integrated whenever the working of any part is consistent with the working of others. In a sense, speaking of an integrated system is the same as speaking of an ordered system. We know, particularly from Hayek, that social order does not imply a rationalist harmonization from the center, but a cybernetic system of interrelations. Properly speaking, the integration of Europe in no way implies the development of a central state to harmonize activities, but rather free competition in all activities.

Thus, a nation—or a supernation—can be defined as a space of harmonization, but it cannot be an optimal space for all activities. The best solution to overcome this difficulty would certainly consist in suppressing nation-states, but it is more frequently maintained that we come closer to the optimum by harmonizing the policies of several different states.

Let us assume for the moment that regulations and the public provision of certain goods ("public goods") are justified. In the present organization of the world, states produce these regulations and public goods. The current world presents intriguing contrasts. In some places, constructivist politicians push toward the enlargement of nations and the creation of supernations, such as the European Union, to which the power to regulate and to produce public goods can be transferred. Meanwhile, however, many people support a more divided world and the dissolution of nations, as in the former USSR, the former Yugoslavia, and in various "national" rebellions. Of course, the pressure for disintegration may come from politicians who have no hope of succeeding on a larger political scale and therefore are fostering the nationalist feelings of a more restricted population in order to gain power, but this pressure may also arise from a general recognition that belonging to a small nation entails no specific costs and allows citizens to be closer to the central power.[3]

The political approach to harmonization parallels the dominant approach in the study of industrial economics by claiming that economies of scale exist, but such a belief reflects a purely technological conception of the issues. The approach that economists such as Friedrich Hayek, Ronald Coase, Israel Kirzner, and Harold Demsetz have developed, in contrast, allows that institutional diseconomies of scale may exist: the larger the scale of production, the more difficult is economic calculation.

3. Tax havens are generally small nations, which may indicate that it is more difficult to plunder the citizens of such nations. Moreover, the smaller the nation, the easier it is to vote with the feet.

In the private ("industrial") sphere, the present tendency is to shift from big production units to a network style of producing. Conceivably, the same might happen in the public sphere. The current transformation of productive structures gives no support to the idea that existing nations are too small and need to be replaced by larger ones. On the contrary, it suggests that a transformation in the working of nations ought to parallel the evolution in productive structures: functional federalism and competition ought to be substituted for political integration.

World or Regional Harmonization

Because harmonization evokes the idea of harmony, it often seems desirable: Would it not help us to avoid anarchy? However, as I have just stressed, harmonization per se—the suppression of differentiation—cannot be considered a valuable objective. In a free-market economy, people do not systematically aim at harmonizing; instead, they seek an optimal differentiation (or optimal homogenization). In speaking of harmonization, we usually refer to explicit policy measures to decrease differentiation between nation-states. Thus defined, harmonization means the international cartelization of policy measures. Unlike a private cartel emerging in a world of free entry, however, a public cartel cannot be beneficial, for two main reasons:

- First, it is built from national areas that are themselves arbitrary and do not correspond to the optimal dimension of all the activities that component states regulate or exercise. Therefore, the argument that the cartelization (homogenization) of these public activities and regulations would bring about net gains has no foundation in reason. There is no criterion to indicate whether a regional or world harmonization of regulations could constitute an improvement.
- Second, such public cartelization prevents competition and makes diversification impossible.

Now, someone might object that even if a world of private-property rights and absolute freedom of action and exchange without the interference of any state were the best solution, the world is not shaped that way, and states do exist. Regulations and taxes imposed in one state have effects on citizens in other nations (the externality argument). Therefore, other states have to make decisions in this second-best world. Can it be the case that, in a world of regulating states, harmonization of regulations would be preferable to their differentiation?

Take the example of protectionism. Nowadays, there is an international organization—a cartel of states—called the World Trade Organization (WTO). Why does it exist? (The same question can be raised about any international organization aiming at international cooperation and promoting the harmonization of policies.) Certainly not for reasons of principle: economic theory offers no justification for the harmonization of trade policies instead of independent decision-making processes. In fact, the WTO exists for purely practical reasons linked to the actual working of politics.

Consider a free-trade world with perfectly determined individual property rights and no public constraint (no state). Now, let us assume that a group of people creates something called a state in a given area inhabited by a certain number of persons (called country A). This state decides to impose a tax or a regulation on some or all of the citizens. That action certainly impinges on individual property rights. We have shifted to a second-best situation (unless one imagines a hypothetical situation in which all citizens, without any exception, desired to be taxed or regulated that way in order to get some public good, the production of which they view as the best possible use of their resources).

Now, let us assume that instead of levying a tax or imposing a regulation on its citizens, the state decides to create a discrimination between "internal" exchange and "external" exchange. For instance, it places a tariff on imports of wine to protect its own producers. As is well known, at least both traders share the burden of this tariff, as is the case for any tax levied on the occasion of an exchange. In other words, the state impinges not only on the property of the inhabitants of country A (who, it is assumed, benefit in return from the production of a public good), but also on the property of individuals in the rest of the world (ROW). But even though some of the individuals who live in the ROW suffer from a deterioration of their situation (a negative externality), this effect is not sufficient to justify either any further intervention in the ROW or any world harmonization.

Let us first assume that, given this situation, a state is created in the ROW, giving birth to country B. The state in country B has neither the means nor a justification for preventing the state in country A from imposing the tariff; as long as the inhabitants of A accept the idea that their state can extract taxes from them, it is perfectly legitimate for the state to impinge on the citizens' property by imposing a tariff. The buyers of imported wine in A (who are also sellers, for instance, of corn and other commodities) react to the corresponding change in the relative price of wine against corn, and it is because of this reaction that part of the burden of the tariff is in fact shifted to the inhabitants of the ROW. What is often called an externality, then, is nothing more than the normal outcome of any change in an exchange economy. As human beings are trading with others, anything that happens to any one of them has consequences for others. A generalized interdependence exists among human beings in an exchange society, and we add nothing to the understanding of this fundamental characteristic of human societies by supposing that some human activities create externalities that have to be centrally managed and, perhaps, harmonized: we all naturally depend on everyone else. There is no essential difference between the assumption we have made—the creation of a tariff in A—and the assumption that a hurricane strikes A and destroys corn crops, raising the relative price of corn against wine. No more and no less externality occurs in the one case than in the other (which implies, by the way, that there is no more justification for harmonizing tariffs than there is for harmonizing hurricanes). Externalities do not exist in as much as property rights have been defined: people in country B cannot complain because the citizens of A have “accepted” a spoliation of their property or even because the people of A suffer from an unwanted spoliation by the state. The people of B do not have a property right to a “just” price of wine (against corn or any other good) or a right to export a given quantity of wine; they have a property right to the wine they are producing with their own land, minds, and arms. They are free to offer the product of their work, but the citizens of country A are not obliged to buy it and are free to create obstacles to the purchase of it.

This case is completely different from the one in which, for instance, a producer in country A emits smoke that soils the house of a neighbor located in country B. That event constitutes an attack against the householder’s property, and he (not his state) is entitled personally to seek compensation or the cessation of the damage. The fact that the relevant individuals live on different sides of a border is not substantial. One is responsible for the damages he is causing to others, whether they are in the same country or another country. A problem arises not because of a so-called externality, but because someone’s property is harmed.[4]

Let us now return to the case in which the state in A has imposed a tariff on imports of wine from the ROW. If a state exists in the ROW (so that the ROW becomes country B), it may want to struggle against the “externality” that the tariff imposes on some of its citizens. Using force (for example, a war against A) would not be legitimate because no one in A, not even the state, has infringed on the legitimate rights of the citizens of B (they suffer from the consequences of what is going on in A, but that is a different matter). The state in B may try to negotiate by arguing that its citizens suffer from protectionism in A. It may even retaliate, imposing tariffs on some imports from A, in order to be in a better position to negotiate. By so doing, it certainly imposes not only a burden but an injustice on its own citizens, whether or not it understands those effects or believes its action will facilitate the dismantling of A’s protectionism. Once more, the only theoretical criterion we possess to evaluate this decision is that it impinges on the property rights of citizens in B. We cannot find any general justification for the policy decided in B. The state may be right or wrong

4. Tariffs have sometimes been considered as ways to extract resources from the citizens of other countries through constraint. Such is the case with the so-called theory of the optimum tariff. As for any tax, the real burden of a tariff is borne not just by the one who actually pays; part of the burden is shifted to the other contracting partner. If all supply and demand curves were known, it would be possible to define a tariff structure such that a government could extract a maximum amount of resources from foreigners. However, this transfer is purely and simply a spoliation of foreigners, who, in exchange, do not receive any “public good,” contrary to what is generally assumed for legitimate taxation. Calling such an act of spoliation an “optimum tariff” is equivalent to saying that it is optimal for an individual to obtain goods not by his own productive efforts but by robbing others of their property. In fact, it is meaningless to speak of optimality without referring to individual property rights. There is no “optimal allocation of resources” except the one made by individuals for the resources they legitimately own.

in forecasting that it will succeed better in its negotiation with A by retaliating, but we cannot develop a general theory implying that its protectionism is justified.

Now we are in a situation in which both countries are protectionist (and the inhabitants of these countries may not even understand that they are being harmed mainly by their own government's policies). Although, in principle, either one would gain by deciding on unilateral liberalization, let us assume they do not do so because neither wants to be the first to suppress protectionism. Believing in the merits of free trade, they may initiate a process of cooperation to negotiate "balanced" liberalization, possibly leading to free trade. They may create something like a WTO, the official aim of which is to make possible international cooperation in trade policies.

As economists, however, we cannot find any general theoretical justification for such an organization. It may be wise to create it from a strategic point of view, given certain specific political and institutional facts, but no such organization rests on a sound universal principle. *There is an unquestionable theoretical—and therefore practical—argument in favor of free trade, but there is no theoretical argument in favor of any world regulation of trade liberalization.*

Moreover, we reach exactly the same conclusion with respect to any activity or problem. We may have personal evaluations of any process of negotiation or state cooperation—some people being in favor of such systems, others believing in other processes—and different parties are likely to disagree, but in contrast to the universal principle that (internal or external) trade is beneficial for both parties, there can be no universally accepted justification for international cooperation between states. Because any regulation in any country changes the conditions of production and exchange, it has consequences for international trade that are reflected in relative prices. If, for example, the state in A imposes some sanitary regulations on food production, the relative cost of food against other commodities is increased, which modifies the conditions of international specialization and exchange. The producers in A claim that they suffer from an "unfair" competition from outside, so that there is a need for a world harmonization of sanitary regulations in order to avoid unfair competition. However, as we have already explained, competition does not imply that all producers operate in the same environment. On the contrary, competition induces producers to compete in spite of different productive situations by imagining different production processes or specializing in different lines. Therefore, there is no justification for, say, tax harmonization[5] or for the introduction of a "social clause" in trade agreements under the pretext that foreign producers have an "unfair" advantage over national ones whenever they are not obliged to apply the same costly social laws.[6]

5. For instance, the Organization for Economic Cooperation and Development (OECD) is promoting a system of harmonized minimum taxation of capital returns.

6. For a more extensive discussion of tax harmonization, see Salin 1994.

Rules and Standards

As markets increasingly become world markets, it is widely believed, related regulations must also be imposed worldwide. This regulation can be carried out in two different ways. Either one national state tries to regulate an activity for the whole world, or specific world organizations take charge of such regulations.

The first case arises especially with regard to regulations of competition. For instance, when the U.S. Department of Justice sues a company (say, Microsoft) because of alleged monopolistic behavior, it does not consider the American market alone, but the entire world market. Similarly, the EU Commission more and more frequently acts as though it has the right to investigate whenever a merger between two big American firms might give them too much "market power" outside the United States.

As regards the second case, international organizations increasingly aim at obtaining world regulatory power. The World Health Organization (WHO), for example, has launched a global campaign against tobacco and is designing regulations (which, for the time being, still have to be adopted by national governments in order to be implemented). Such evolution is particularly frightening because it seems to augur the emergence of a worldwide system of surveillance of individual behavior. Whatever the real dangers of smoking, they constitute a purely individual problem. The arguments normally used to justify a world regulation (externalities, economies of scale) cannot apply in such a case. But, to turn the trick, it seems sufficient to claim that the WHO is in charge of world "public health" and that smoking belongs to that category.

Seeing no justification for such regulations—and more generally, for any regulation—we obviously might have difficulty in imagining how the internationalization of regulations can be any more justified. In short, the problem is not that, in a world of globalization, the regulations in favor of competition and against monopolies are national in scope. The problem is that such regulations exist at all.

Nonetheless, let us consider the specific problem of standards. By definition, a standard is more useful as it is adopted by a great number of people, and from that point of view there is certainly a need for homogenization. But, once again, the market can meet that need.

Given that public national standards already exist, we have to wonder whether anything can be gained by replacing national standards with international ones—the approach that the European Union prefers. It may seem that such an approach is justified to the extent that a decrease in the number of standards would benefit both producers, who can sell to broader markets and exploit economies of scale, and consumers, who will enjoy lower information costs and acquire compatible goods. But our previous reasoning can be transferred to this specific problem. Rather than forced uniformity of standards, we may prefer competition in standards, including public ones.

From this point of view, institutional arrangements are important. A famous decision of the European Court of Justice (Cassis de Dijon) specifies that a European country cannot prevent the import of a commodity produced in another country in which different standards are imposed on producers (say, for health or safety reasons). This decision allows a certain degree of competition in public standards. Consumers, who must be considered responsible persons as regards their own health or safety, have the right to choose between different standards. It can be expected that, little by little, the market will select the most desired standards. But full competition in standards would imply not only that imports of goods produced according to different standards be accepted, but moreover that in any country the producers be allowed to use the standards used in any other country (at least, as regards the EU, in other European countries). Similarly, it is often claimed that a single business law (for example, to define the workings and the organization of firms) would be preferable in Europe. A more competitive approach, however, would consist in allowing any firm in any country of the EU to be constituted according to the law of any member country. One may guess that, little by little, the market would choose the type of organization that shareholders, creditors, wage earners, and suppliers prefer.

The usual justification for public intervention in the definition of private standards is the following: either a multiplicity of standards exists, which is not efficient, or one standard becomes dominant, creating the risks associated with monopoly. In such a case, despite free entry into a market in principle, new producers cannot actually enter because a dominant producer has become established. The first producer in a market benefits from a sort of snowball effect. In network activities in particular, a cumulative process occurs: people buy a good (computer, program, telephone) according to a certain standard because they know that many people are using the same one, and by so doing they augment the market share of the producer. States care about this problem for two reasons:

- First, it is argued, consumers may be "obliged" to use a given standard because it is dominant, even though technically it is not the best. Many examples have been proffered, such as the standard typewriter keyboard and the VHS recording standard (which, at least in France, was said to be inferior to the French standard). Therefore, a system of world cooperation to define common standards would benefit consumers by allowing them to get products conforming to the best technical standard.
- Second, the existence of a dominant standard, used by one given producer, would create barriers to entry protecting the dominant producer from any competition, so that free entry would be ineffectual in practice.

These arguments have been made in the Microsoft case (see Liebowitz and Margolis 1999), and they are being used to promote the public definition of standards, possibly for the whole world, but they are not sound. The choice of a standard has to be considered as only one element, even if a fundamental one, among the choices that firms make concerning their strategies and production processes, as the recent history of the computer industry clearly illustrates. More fundamentally, that choice has to be seen as necessarily implied by freedom of contract. Obviously, there is not a single computer standard for the entire world, and we have all met with difficulties in communicating between the PC world and the Apple world. However, the competition between those two operating systems has spurred innovation. It seems that Apple has led in developing new techniques, but it has not obtained the dominant market share that seemed warranted by its technological superiority because it failed to choose the best marketing strategies. As is well known, Microsoft chose to make its software available to all computer producers, whereas Apple chose to link the production of software and hardware.

One might dream of a world in which all computers used the same standard, and some might be tempted to support a regulation imposing the "best" standard. However, because the choice of standards cannot be separated from the choice of overall industrial strategies, it is an illusion to believe that anyone can decide which standard is the best for the present and the future. The dominant standard—Microsoft's—might become obsolete with the appearance of new standards, such as Linux, especially as technological developments are very rapid in the world of computers and the Internet. In the near future, the dominant firm may not be a producer of operating systems and programs for personal computers, but for central operators to which personal computers will be linked.

The diversity of standards has a cost, but it brings profits to consumers as far as it is a vehicle for innovation. From this point of view, the differentiation of standards can be viewed as equivalent to any investment: it involves bearing a cost in order to get a future return. Those who adopt a technological approach to economic problems think that the optimal number of standards in any domain is one, so the fastest way to obtain this result is for some world authority to impose this one standard (assuming that those who decide do know which is the best norm). But it is likely that from an economic and realistic point of view the optimal number of standards is greater than one. As I already stressed, the optimal degree of differentiation or homogenization cannot be decided from the outside or from above. It has to emerge from experimentation, it has to evolve over time. As Friedrich Hayek stressed, we ought to focus not on results, but on processes. If there is free entry, the market will determine the optimal number of standards. No sound argument can be made for a determination of standards either by a world authority or by some process of cooperation among national authorities.

If a dominant firm and a dominant standard should come to exist, it would be incorrect to conclude that the process of competition must not be working and therefore that the state must intervene to impose competition (a contradiction in terms), as the U.S. Department of Justice is claiming to do in the Microsoft case. The oft-used argument about barriers to entry implies that, given certain technical conditions, whenever a firm owns a standard, it is impossible for other firms to enter the market, and hence competition cannot be said to prevail. That argument is fallacious. In fact, when today's dominant firm first entered the market, any firm was free to enter and to propose its own standard. If other firms did not do so or if they have failed, then they have made a bad choice or declined to take the risk of developing this new activity or standard. We cannot and must not try to rebuild history. If public authorities were entitled to cancel a process whenever those who had not invested in it were unsatisfied with the result, innovation would be riskier, and many activities would never develop. The only genuine barriers to entry are those that governments erect. If any harmonization is necessary, it consists in suppressing all such official obstacles and regulations.

International Public Goods

The strongest case in favor of world regulations and harmonization seems to be the argument based on so-called international public goods. In a sense, among the problems we have already considered, international standards can be viewed as international public goods (though, obviously, health recommendations such as those concerning smoking do not qualify), but we have also seen that the nature of standards in no way justifies their public production. Still, belief in the existence of international public goods is widespread and forms the basis for many international agreements and organizations, such as those aimed at protecting endangered species, tropical forests, sea resources, or the atmosphere—all such things being considered part of the "wealth of humanity."

To say that these resources are part of the wealth of humanity, however, is also to say that they have no owners, so that it is impossible to define individual responsibilities for their preservation. In fact, ironically, the best way to make certain that a specific animal species will disappear is to declare it to be part of the wealth of humanity and to have states sign international agreements to protect it. As is well known, the only way to protect elephants, rhinos, or tortoises is to privatize them. Clearly, protecting these animals does not correspond in any way to the traditional definition of producing a public good because exclusion is possible and rivalry takes place in the use of the resources. Therefore, even those who endorse the traditional definition of public goods ought to recognize that applying it to the preservation of such animal species is inappropriate. Likewise with respect to forests. The problem of saving the Amazon forest, for instance, arises because the Brazilian state is the legal owner of the forest and allows woodcutters to cut down trees. Those harvesters have no incentive to grow new trees; they do not own the land and would not benefit from such action. The best way to save the Amazon forest is to privatize it (remembering to leave part of it to the indigenous people who have been its first settlers).

The problem might seem different as regards, say, the seas or the atmosphere because it is impossible to privatize moving water or air, and therefore only global public management (with possible concessions) can be imagined as a solution. Exclusion seems to be impossible; hence, the atmosphere and natural bodies of water appear to be perfect examples of public goods. No one has any incentive to refrain from polluting the atmosphere, but if all human beings pollute, they all suffer from the global pollution. It would seem to be in their interest to accept regulations or taxes in order to decrease the level of air pollution. Such thinking has inspired the recent Rio and Tokyo conferences, and a consensus about public management of seas and the atmosphere appears to exist.

Evaluating these arguments would take me beyond the limits of the present article. Here, I wish only to stress that no good or service can be considered a public good by nature and forever. In a sense, then, public goods do not exist. Obviously, in innumerable cases, people prefer not to define property rights because the cost of defining them with existing techniques would be too high in comparison with the benefits thereby obtained. Instead of labeling these goods and services as public goods, however, it would be preferable to call them *nonowned goods*. Among them, some are not produced; some are produced by individuals who do not care that other people benefit from their production without paying (the case, for example, with private streets); and some are produced according to collective decision-making processes. In the last class, an important distinction has to be made between two categories of goods:

- First, there are those goods produced by people who freely enter into voluntary agreements. Whenever one buys an apartment in a condominium, for example, one accepts in advance a collective-decision rule, such as the majority-voting rule, for determining the provision of common services.
- Second, there are those goods produced by coercion—namely, the use of the tax power and the regulatory power of states. The underlying idea is that no citizen would voluntarily pay for the provision of the so-called public good even though each person would benefit from its production, so coercion is necessary. Everyone is obliged to pay.

Now, the only case in which it can be said that there is consent to be coerced is that of unanimous agreement, but this case is obviously purely fictional (except in very small communities). Most often, individuals disagree, and by means of a device such as majority rule one group forces another group to pay under the pretext that the produced good is a so-called public good. The probability of disagreement increases with the number of people involved in the decision-making process. Moreover, the larger the nation to which people belong, the more difficult it is for them to vote with their feet—an important reason to oppose political integration and, on the contrary, to favor the splitting of existing nations into smaller and smaller entities. A world of millions of small condominiums ("states") is better than a world coalesced into a small number of supernations (Europe, North America, and so forth). The absolute nightmare is a world government, from which individuals would have no possibility of opting out.

Although we recognize that it is not as easy to establish property rights to the seas or to the atmosphere as it is to establish them to animals or trees, production of a good by coercion is the extreme and worst solution, so we must explore other solutions. Technical or institutional solutions may be devised to overcome the apparent difficulties in the definition of property rights and, therefore, in the definition of individual responsibilities. I do not claim to know the solutions; they must be discovered over years, centuries, or milleniums to come. But we do know that whenever a public monopoly exists, technical and institutional innovations are impossible because no one has any incentive to develop them. This fact alone is a sufficient justification for rejecting public provision of goods, even those that seem to be international public goods.

The existence of national zones in seas and oceans makes it impossible to invent ways to define property rights in the use of water and its resources (fish, mineral resources under the sea, and so forth). The existence of international standards for pollution or the development of ecological taxes by international cooperation makes it impossible to improve the precise definition of the respective rights of the polluters and those damaged by pollution. Other solutions can be devised, however. Here, I only sketch some possibilities.

In the case of fisheries, suppose that nations have no rights on the seas: no distinction exists between international and national waters, and all are open to private appropriation. The fundamental principle is the right of the first settler. No one owns all parts of the seas because no one has used all parts of them. (The conquistadors erred in supposing they could make themselves the legitimate owners of all of Latin America just by putting their feet on the beach.) For fishermen, there is no need to define private-property rights so long as fish are not scarce, but the users of a specific area have an interest in preventing the exhaustion of its fish resources. Therefore, if the entry of new fishermen threatens the renewal of the fish, the first users have an interest in defining and protecting their specific use of the sea in specific areas (but not everywhere for every use). Having established their rights, the first users can decide to forbid the entry of an additional fisherman or to sell him fishing rights. As owners of property rights, fishermen have an interest in avoiding overexploitation of the fish stocks. One might object that it is difficult to define and to protect such property rights, which is true, but it is no less difficult for a state or a set of states to define and prevent overexploitation, and no one can deny that the incentives differ in the two cases, to the detriment of public management.

The most difficult problem to be solved may be that of atmospheric pollution. As an example, consider the hole in the ozone layer. It is assumed that the production and use of chlorofluorocarbons (CFCs) cause the progressive enlargement of the hole, which, in turn, has undesirable effects on health. The usual approach to the problem consists in imposing regulations and ecological taxes. Now, it should be obvious that we care about the ozone hole only as far as it may have definite unwanted effects on our health. Now, either we have good information on the causal relationship, and we know who is producing the harm and who is suffering and to which extent, or we do not. If our information is very imperfect—as it now seems to be, inasmuch as scientists strongly disagree about this problem—the mere fact of taxing or regulating the supposed cause does not create any new information about the process. The level of regulation or taxation cannot be optimal. The changes in the allocation of resources brought about by these policies may be too great or too small, considering the value attached to the sacrificed alternative uses of resources. Moreover, the use of ecological taxes to reduce global atmospheric problems seems paradoxical. If these problems are serious, they are so only as far as they create victims. Why should the state rather than the victims receive the receipts of the taxes? Establishing taxes or regulations to solve a global problem is not the real issue. Rather, the crux of the issue consists in gaining better knowledge of the problem and in devising the best institutions to come closer to defining and achieving the optimum level of pollution. That level, however, cannot be defined independently of individual values as expressed by individual choices.

A judicial solution, stemming from the principle of responsibility, would require that an individual who believed that he suffered from some disease (in a definite way, with visible and specific damages) because of the ozone hole would seek out those responsible for causing his illness, for example, the producers of CFCs, in order to get compensation. Viewing the problem in that way, one sees that it is not a global problem—a public-good problem—but one with different effects on different individuals. If no specific victims exist or if the alleged link between an individual's harm and someone's prior actions cannot be proved, then the problem is purely fictitious.

It will certainly be objected that a system of individual responsibility cannot be efficient because an isolated individual has no real ability to sue a great number of wealthy producers, even if many individuals are in the same situation. Therefore, no one would have a personal interest in fighting those who are destroying the ozone layer before specific damages are observed. Under such conditions, it would be simpler for a small number of governments, assisted by experts, to determine ideal health conditions and to act accordingly. Traditionally, public-good theory has been applied along exactly such lines.

One is mistaken to suppose, however, that individuals have no means to protect their own health when it is threatened by pollution. Individuals certainly have an interest in acting where their own health is concerned. Moreover, if it is easy to evaluate the causal relationships linking CFCs, the ozone hole, and health damages—as states that set ecological regulations and taxes implicitly assume—then the cost of seeking a judicial solution will be low. If such causality cannot be shown, why should governments impose taxes and regulations to prevent a phenomenon of questionable existence and consequences?

How can a victim sue a great number of polluters? We cannot imagine all possible solutions, of course, but we know that in a world founded on the recognition of individual rights, new solutions will be created. The following possibilities are only illustrations of possible solutions. First, associations of victims can be created and sue the offenders. The advantage of this solution over a statist solution is that the association consists of specific victims who have suffered definite damages. The very threat of litigation by future victims would certainly modify the behavior of polluters, if they believed that a causal relationship does exist and if the polluters could be convicted in the future. Evaluation of actual risks and the search for solutions would therefore proceed gradually, according to real needs and without brutally upsetting the whole pattern of coordination of human choices. In a sense, scientific expertise would be produced at an optimal rhythm in accordance with the needs of those most immediately concerned.

The most likely outcome of a purely individual approach to pollution problems is that insurance firms would play the role of intermediaries between the victims and the polluters. A potential victim would be insured against "global pollution," and polluters would be sued not by individual victims but by insurance companies, thus creating a better balance between contending parties. Moreover, modern techniques of insurance would certainly make it possible to replace a great number of insurance companies with one or several big reinsurance companies.

Symmetrically, a potential polluter might be insured against the risk of causing indirect damages to individuals, and insurance companies would have an incentive to play a role as regulators of pollution. They would have an interest in controlling polluters and would demand higher insurance premiums for coverage of greater potential risks. Little by little, a complex system of risk transfers and risk controls would certainly emerge and, without being perfect, would make possible a convergence toward an optimal degree of risk.

In any event, such a solution would be superior to the usual government solution. When the environment is nationalized—or globalized by a world organization—no one bears direct responsibility for damages caused to specific individuals. Future victims would receive no compensation, even though huge ecological taxes would fill the coffers of national states and world organizations.

Conclusion

In brief, alleged global problems—such things as a sustainable worldwide growth, international externalities, and international public goods—do not exist as such. There is only a world network of individuals who have rights and who are interdependent. They have to devise solutions to their own problems. The price system and the judicial system are the most powerful instruments they can use in making ever-changing adjustments.

References

Liebowitz, Stan J., and Stephen E. Margolis. 1999. *Winners, Losers, and Microsoft: Competition and Antitrust in High Technology.* Oakland, Calif.: The Independent Institute.

Salin, Pascal. 1988. The Contribution of Flexible Rates to an International Monetary Order. Paper presented at the Mont Pèlerin Society meeting, Tokyo/Kyoto, September.

———. 1994. International Tax Problems: Between Coordination and Competition. *Journal des Économistes et des Études Humaines* 6 (March): 3–23.

——— 1996. Cartels as Efficient Productive Structures. *Review of Austrian Economics* 9: 79–82.

Acknowledgments: An earlier version of this article was presented at the Mont Pèlerin Society General Meeting, Santiago de Chile, November 12–17, 2000. I thank François Guillaumat for his comments on a previous version of this text and for his useful suggestions.