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# Checks and balances outside the government: an introduction to the symposium[☆]

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ABSTRACT

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The symposium brings together case studies that are all about reasonably successful experiments in institution building and policy making by interactions between public and private spheres. The cases deal with the provision of information enabling market to perform, law making, and the control of political discretion and public bureaus. Each in its own way, they show how agents have room for some reasoned choice, although eventually this room for choice is narrowed by the emergence of stabilized institutions that come to shape in a rather permanent way the environment within which they later operate. The common characteristic across these case studies is the non-Parliamentarian process through which process of experimentation, rationalization and institutionalization takes place. *Journal of Comparative Economics* **44** (2) (2016) 400–403. Université Paris Dauphine, PSL Research University, CNRS UMR 7088, DRM, Place du Maréchal de Lattre de Tassigny 75016 Paris, France; Sciences Po - C.E.R.I. 56 Rue Jacob, 75006 Paris, France.



In common with most social scientists and political philosophers, economists agree that the division between the private and public spheres is a characteristic of modern liberal societies, one that bears heavily on how they work and how their economies perform. A society where this divide were to be abolished is typically envisaged with awe, as it would imply that the integrity of personal lives and properties would also disappear or be left without any tangible means of protection. It would be impossible for a market economy, an independent civil society or an open and competitive polity to survive. Yet the way in which the division of labor between public and private spheres is structured and how it shapes social interactions is infinitely varied.

The four articles that make up the following symposium come with somewhat eclectic objects, though each of them addresses from its own perspective the range of problems that stem from the interaction or the division of labor between public and private rules and organizations, in the context of an open, competitive market economy. The first article, by Peter Grajzl and Nataliia Laptieva, looks at how information is provided to commercial banks in the Ukrainian credit market. The

☆ In September of 2011, a conference was held in Florence under the auspices of the European University Institute (Global Governance Program) and the University Paris-Dauphine (Institutional and Organizational Economics Academy, ex. ESNIE) on the relationships between legal orders, the organization of states, and economic development. The papers in this symposiums draw from this meeting. The editors are grateful to the EUI and the University Paris-Dauphine for their support.

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two articles by Jérôme Sgard and Carmine Guerriero then look at the legal system and specifically at the Common Law tradition and how its case-based approach allows for close interaction between private dispute resolution and law-making. Lastly, Barry Naughton explores the close relationship between two of the most powerful political hierarchies in the world, namely the State and the political party that runs China. In other words, the first paper is about the provision of key public goods (information), the second is about lawmaking and the third focuses on vertical, discretionary authority and how absolute power can possibly be checked. Each of these themes thus illustrates a classical, well-identified dimension of what the State does and how it interacts with economic agents or citizens in general.

Furthermore, these four papers discuss in particular the possibility of exiting (or not) the public rules, leading to competition and evolution. Indeed, we generally expect that public goods providers operate in a context where competition is absent or problematic, and they often tend to be long-lived, and possibly entrenched. More often than not, information providers, courts and bureaucracies are monopolies and this explains why they often follow quite specific rules of governance. The risks of rent-seeking and bureaucratic involution, and more generally of low-efficiency, evolutionary traps stem from here.

The article by Peter Grajzl and Nataliia Laptieva on the collection and dissemination of private information on borrowers to Ukrainian banks offers a straightforward example of strategic goods that directly condition the operation of credit markets. Moreover, we know that depending on the country these goods can be offered either by the private or the public sector, even though, in all cases, the microeconomics of this market is not standard. Economies of scale and network externalities weigh heavily on the chance of success of individual providers; there is often a built-in preference by the demand side for a single supplier; and success on the supply-side often hinges on the capacity to establish itself as a neutral third-party that may collect information from various private firms, while respecting confidentiality and at the same time avoiding conflicts of interests. The criticisms that have been made of rating agencies over several years, and which have led to frequent calls for regulation, provide a clear and closely linked illustration.

As shown by Grajzl and Laptieva, in Ukraine both the public and the private sector provide information on non-payments. First, as in many other countries, the Central Bank operates its own credit information system, typically as a by-product of its core regulatory and supervisory function. The Bank's organizational network and its trusteeship of the domestic banking system offer at this point strong comparative advantages. Yet, it can also happen that a public trustee is not trusted, for instance because its constitutional foundations are seen as weak or corrupt. This might be one reason why, in Ukraine, private credit bureaus were established that also provide information on borrowers on a competitive basis: the trend towards a monopoly provider was resisted. The great added value of Grajzl and Laptieva's article is to show the commercial banks' own private judgment on this plurality of information providers: while access to the Central Banks database does not affect their willingness to lend, access to private providers is associated with a statistically significant increase in lending. Moreover, the coefficient of correlation is increased when commercial banks rely on more than one private bureau. This suggests that they not only trust more private firms than the Central Bank, they also trust competition.

In other words, in Ukraine's case, the public good character of market information is not founded on a formal agency structure or, say, a constitution with credible commitments not to abuse the public. Neither is it based exclusively on the adequate self-regulation of a single, private supplier. Apparently, the plurality of voices, hence the possibility to check them one against the other, is seen by private banks as the best guarantee against abuse or agency flaws.

Bankruptcy laws offer a different point of entry into the broad debate on the public regulation of markets and contractual relations. Since the Middle Ages bankruptcy procedures have typically been the monopoly of State courts that issue judgment in the name of the sovereign – either the King or the People. The key reason for this enduring pattern is that a generic bankruptcy procedure starts with the suspension of the contractual rights of lenders and borrowers alike, so the execution of contracts is put on hold. Payments are suspended, individual remedies don't work, the owners and managers can act only under tight control, private correspondence can be opened up and, of course, the whole process is made public. This judicial procedure thus discretely moves the parties from decentralized, market-based transactions, where the will of the parties reigns, into an entirely different institutional environment where their interactions, the circulation of information and decision-making follow essentially collective rules and are closely monitored by a judge.

Moreover, whether it leads to a restructuring agreement or liquidation, this eventual decision is also collective, meaning it is governed by a qualified majority rule: typically the property rights of minority creditors will be impacted against their will. Still, the legally binding character of this decision does not flow from the collective deliberation of creditors, as in a kind of small parliament. Only a (public) judge has this authority, which he exercises within the strict rules of statutes, after having observed the results of the creditors' vote: he actually interprets it as the best available indication of where the joint interest of the parties lies, and so he sanctions it. In a standard market economy, there are few occasions when such powerful vertical intervention by a State authority in private rights is warranted and largely accepted.

Hence, in contrast to the case of information provision to Ukrainian banks, a clear choice between two separate routes for resolving insolvencies is just not possible in the case of bankruptcy. Arbitration tribunals for instance have never been allowed to take over bankruptcy cases, and a radical libertarian would not ask to transfer these critical decisions to private regulators, he would rather argue that this authority should be abolished. Hence, the public character of this service does not derive from practical or microeconomic considerations, like economies of scale and network externalities; neither does the discussion boil down to a choice between alternate agency structures. Here, the very notion of "the public" is about a rule that is just not negotiable and that does not leave agents with liitle alternative options. This more compact and more constraining variant of public authority might thus corresponds with what we generally understand as "sovereignty", a