

Ifo Viewpoint 28

Whither Systems Competition?

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### Whither Systems Competition?

The old systems competition between East and West aimed at military superiority and has, meanwhile, been decided. Globalisation and European integration, however, are producing a new systems competition, whose outcome is yet unknown. The new systems competition aims at improving a location's attraction for potential tax payers and at repelling the state's borders, and it follows completely different laws than the old one.

The consequences of the new systems competition are drastic reforms of regulation and taxation systems in many countries, improving competitiveness from a national point of view. Germany, too, must make great efforts to introduce long overdue reforms in order not to fall behind even further. Economists largely agree on the nature of these reforms.

Quite another problem arises if system competition is not viewed from the vantage point of an individual country; but rather if the consequences are considered which follow for all countries together if they are successively subject to systems competition in ever new rounds of reforms. The historical processes are still largely understood which unfold over decades, but then bring forth even greater changes. How far do the analogies go between private competition and the competition of states? May we expect that systems competition works as well as the competition in private markets?

Theoretical analyses show that the answer to this question is likely to be "no". Since governments intervene where the market fails, we must fear that the reintroduction of the market on the higher level of state competition tends also to fail (selection principle). Thus we must expect, for example, that competition among social states results in competition of repulsion (United States), that competition with taxes and infrastructure leads in the end to subsidisation of capital input (east Germany) and that competition of bank regulation systems causes a dangerous increase in lemon-banking (Asian crisis).

For these reasons globalisation must go hand in hand with a change in the framework of system competition. It includes, for example, the proposals to integrate immigrants into the social system only after a certain

delay, to harmonise taxes on capital earnings in Europe, to extend the EU ban of subsidies to the provision of infrastructure, and to harmonise bank regulation as planned by the Basle II agreement.

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