

# COMPETITIVE GOVERNANCE, PUBLIC ENTREPRENEURSHIP, EFFICIENCY, EQUILIBRIUM, AND PROCESS THEORY

Excerpts from “Paul Dragos Aligica, *Public Entrepreneurship, Citizenship, and Self-Governance*, Cambridge University Press: Cambridge 2018.”

The structure and functioning of any self-governance system is intrinsically dependent on the initiative and problem-solving capacities of the participating members. Irrespective how one designates the factors that link the initiative of social actors with the dynamics and problem-solving capacity of the system, they represent a key to understanding self-governance. Using as an inspiration the scholarly literature that has explored similar factors in the context of the market process, the notion of entrepreneurship renders itself as an excellent vehicle in this respect. Extending the study of entrepreneurship from market to non-market settings brings however to the fore a set of theoretical and methodological challenges deriving from the fact that the emphasis has to be not so much on commonalities but on the specific difference between public forms of entrepreneurship and the more familiar forms taking place in market settings. Part 1 of the book advances to a new stage the Ostromian approach to the identification and conceptualization of entrepreneurship in non-market settings. It puts together the building blocks of a conceptual apparatus that leads to an analytical and functionalist-structural perspective more theoretically coherent and more consistent with already existent, more advanced, theorizing of entrepreneurial action in market settings. Below is an overview of the structure and argument of this part of the book followed by an excerpt illustrating the insights behind the application of equilibrium analysis to polycentric governance systems.

Link to the book: <https://www.cambridge.org/core/books/public-entrepreneurship-citizenship-and-selfgovernance/075604D3BADB3F2AA91304868F54CAF3>

Part 1 of the book builds on three insights:

- (a) Public Entrepreneurship is institutionally contingent. It is a phenomenon whose emergence, structure and dynamics is not purely individual, behavioral and psychological but is a function of a specific institutional ecology and the decision arenas created by that. To be able to identify the Public Entrepreneurship function one needs to identify and use the logic of the institutional setting and the social ecology in which the action takes place.
- (b) Public entrepreneurship is a phenomenon intrinsically related to collective action and the problem of collective action is part and parcel of its identification, definition and analysis. The problem of collective action is the ultimately defining reference point for the public entrepreneurship function. More precisely, approach advanced by this book opens the way to an innovative approach to public entrepreneurship seen as a second order collective action problem: a collective action induced process that aims at solving collective action situations.

(c) The concept of Public Entrepreneurship implies a theory of voluntary association. The diverse institutional settings and action arenas within which Public Entrepreneurship may emerge and operate are all domains of voluntary action, defined by significant degrees of freedom of exchange, choice and association. The Ostroms' work offers the conceptual instruments to chart at multiple levels (micro, mezzo and macro) and from different angles, that diversity of settings that are defined by polycentric overlapping, cooperating and competing arenas of collective action. The articulation of these multiple dimensions, levels and angles allows us to isolate and illustrate the Public Entrepreneurship function in ways that are more nuanced, theoretically precise and empirically relevant.

The crucial insight is that following its intrinsic logic, the concept of Public Entrepreneurship brings to the limelight a set of theoretical and conceptual elements associated to and implied by it. The concept has a clear descriptive and analytical meaning only when seen in the context of those assumed and implied elements. In this part of the book they are grouped under three clusters: (i) polycentricity and competitive governance related (Chapter 1); (ii) collective action related (Chapter 2) and (iii) voluntary action and association related (Chapter 3).

In conjunction they offer a unique, coherent and nuanced understanding of how some of the basic intuitions and insights surrounding the notion are in fact elements of a conceptual system that (a) anchors the theme in an area extremely relevant for the current governance theory debates; (b) puts in a new theoretical light the problem of entrepreneurship in public action arenas, and (c) may even open up a fresh theoretical view on the relationship between entrepreneurship and political processes in general. The notion of public entrepreneurship reveals itself as a most constructive and fruitful entry point into the complex conceptual universe of self-governance theory.

(...)

## **Public Entrepreneurship, Efficiency, Equilibrium, and Process Theory**

Putting the pieces together and articulating explicitly the links between them, one may make yet another step further in elaboration. Using the broad notions of “competition” and “competitive systems” as benchmarks, one may construe a spectrum of ideal type social systems. At one end, monolithic systems, closed to competition. At the other end, composite, compounded systems with power and decision-making divided between multiple centers, and thus engendering competition. We have shown how the Ostroms assume for their treatment of public entrepreneurship a situation closer to the competitive end of the spectrum. In such systems, public entrepreneurs “are given both incentive and opportunity to configure and reconfigure productive organizational and inter-organizational arrangements” (Oakerson and Parks, [1988] in McGinnis 1999, p. 326). We have also seen that the Ostroms noted the “efficiency enhancing” properties of systems that allow the experimentation with such diverse organizational and institutional reconfigurations. As noted by Oakerson and Parks ([1988] in McGinnis 1999, p. 326) public entrepreneurship as a response to citizens' preferences in competitive conditions

can explain the “efficiency-inducing properties of polycentricism.” Addressing the problem of this tendency towards equilibrium in matching resources to needs, and towards efficiency in provision, takes us to the last step in fully specifying what the Ostroms’ view of public entrepreneurship entails.

Mainstream economics insights provide a benchmark and a starting point, that could be then transcended in a broader political economy perspective. In neoclassical economics the logic of a competitive system operating on supply and demand of goods and services leads towards a well specified equilibrium. That equilibrium is explicitly associated to various criteria of efficiency. Once we shift attention from market competition to competitive governance, one implicitly faces the following question: What is “efficiency” and what is “equilibrium” in a non-market competition mode of the type hinted at by the Ostroms? What is the nature of the “equilibrium” (if any) towards which competition in this broader action arena is pushing? What is the meaning and nature of “efficiency” in such a case?

By all accounts, although the Ostroms did not elaborate this line of argument, it looks like one concept of efficiency expounded in the traditional literature is closer than any other to their intuition. This is the Wicksell-Lindahl efficiency or Wicksellian efficiency: In the Ostroms' perspective, the connection between the costs and the benefits of publicly supplied goods and services is crucial. In their view, citizens try constantly to assess the costs and benefits of various public goods and services, weigh them and act accordingly. But this is precisely the feature of what is known as the Wicksellian approach to efficiency. This approach takes us to the link between (a) the taxprice citizens pay through taxes for the goods and services provided by governments and (b) the valuation the same citizens place on those goods and services. The closer the match, the more efficient the system. By definition, the better aligned the price and the valuation are to each other, the closer the system is to efficient equilibrium.

In its purest form, the model postulates a collective decision about expenditures and a collective decision about revenues, made simultaneously and unanimously. The connection thus formed between costs and benefits is of such a nature that the resulting collective decisions are Pareto-efficient (Breton, 1996, p. 23). This Wicksellian optimum is an ideal situation, an imaginary state helping us as a benchmark or a heuristic device. It is built using a set of assumptions typical to neoclassical economics, including the full information and rationality of the decision makers. The problem is that, useful as it is, the benchmark itself says little about the process leading to the alignment of demand and supply of public goods and the efficiency inducing features of this process. It is pointing in the right direction but it is not a fully satisfying solution. For instance, Wicksellian efficiency assumes that the objects of choice are already available. The solution set, in the form of public services or in the form of organizational means to provide those services, is assumed to be already discovered and in place. Entrepreneurial actions are thus simply assumed away. Here is where the limits of neoclassical economics inspired models become palpable. The difficulties in conceptualizing entrepreneurship within the neoclassical framework are notorious. If competition in the public goods economy is a quasi-market process then we must be able to specify a theory of a quasi-market process and an explanation of the tendency towards equilibrium that create a room for entrepreneurship and its theorization.

The last step in our argument will be dedicated to that task. In our efforts to delineate the firmer contours of the Ostroms' perspective we need to introduce a notion and theory of competition that departs from the mainstream version, while retaining some less stringent version of the conceptual benchmarks (such as equilibrium, rationality, efficiency) that have been so useful so far as a heuristic and definitional instrument. Fortunately, a theory that fits the description has already been advanced in social sciences by an important school of political economy initiated by C. Menger during the second half of the 19<sup>th</sup> century, continued via L. Mises (1949 [1996]) and F.A. Hayek (1945), and relabeled, in the second half of the 20<sup>th</sup> century by Israel Kirzner, a "process" theory (Kirzner, 1992, 1973; Boettke, 2012; and O'Driscoll and Rizzo, 1985). Its conceptual apparatus provides the needed element in our elaboration of the Ostromian perspective on entrepreneurship theory.

Its distinctive feature lies in its interpretation of equilibrium and disequilibrium amidst rivalry and competition as a background for a clearly stated theory of entrepreneurship. The approach changes the emphasis: while the neoclassical approach focuses on optimal resource allocation problems and the mechanics of equilibrium, the Austrian approach focusses on the process of adjustment itself and to the path towards equilibrium, including the variety of disequilibria on its way. The static properties of the system in equilibrium are replaced with alertness, change, discovery, invention and creativity and –as importantly- with an emphasis on the processes related to them. The neoclassical mechanist and algorithmic perspective is thus replaced by a process view. Competition itself becomes more realistic and not a mere abstract assumption for a formal allocation modelling exercise.

Seen in this light, the market and the competitive process are not a matter of efficient allocation configurations but a matter of *dynamic adjustment*. For instance, when it comes to market processes, prices serve as the basis of economic calculation "only in the context of a process of competition brought into being by what formalism assumes away: disequilibrium" (Boettke, 2012, 280-81; O'Driscoll and Rizzo, 1985). Various states of disequilibrium and their competitive features become crucial. On the one hand, there is the tendency to depart from equilibrium. Discovery, error, changes in the environment or acts of Schumpeterian entrepreneurship fuel it. On the other hand, is the tendency towards equilibrium, via the price system fuelled by "arbitrage" (Kirznerian) entrepreneurship that acts in the direction of matching resources to demand and thus pushing things towards increasing efficiency.

In brief, this so called "Austrian" approach offers a theoretical framework that gives meaning to entrepreneurship both/either as a force operating on the tendency towards equilibrium or as a disequilibrium factor. Kirzner (1997, p. 81) clarify that this theory "makes no claim that the market outcomes at any given date are efficient and socially optimal (in any sense in which traditional neoclassical welfare theory would use these terms)." Instead, the market works as a system of incentives and information conducting actors to adjust their behavior and engage in error correcting. Thus it is inducing a tendency towards equilibrium. "We appreciate that there are equilibrating forces but that doesn't mean that an equilibrating process is at all times in progress." Therefore, explains Kirzner: "...the social significance of a market system does not reside in the beauty of the allocation pattern under equilibrium conditions." Instead, "it rests upon the capacity of

markets to translate the errors made in the immediate past into opportunities for pure entrepreneurial profit of direct interest to potential entrepreneurs.”

For our purposes it is important to also note that “Austrian” theorists go at length explaining that this process and its capacities are a function of a particular institutional framework. It is not only the signaling and production and dissemination of relevant knowledge that we typically attribute to the market. The institutional environment also may help or hinder this adjustment-and-discovery process by linking “socially significant opportunities” with “the likelihood and security of associated entrepreneurial gain” thus “improving the chances for entrepreneurial discovery” (Kirzner, 1984, p. 56). Kirzner (1982, 1997) calls this ongoing institutionally induced process of adjustment, alertness, discovery, learning and error correction, taking place within a secure system of property rights, the Entrepreneurial Process.

Based on all of the above, it is understandable why the argument outlined above could be relatively easily extended outside the domain of the market. In fact Austrian-theory-inspired scholars have developed a rather concrete series of applications to problem outside of the typical sphere of the market. Christopher Coyne’s (2013) work on humanitarian interventions is paradigmatic for the application of Austrian ideas to concrete case studies of direct relevance to voluntary, non-profit social actions and institutions. Related applications to the problem of interventionism and civil society have been made on the problem of disaster relief and recovery using research designs operationalized in field research and in-depth case studies (Chamlee-Wright, 2010; Storr & Grube, 2014, Storr, Balch and Grube, 2015).

It is rather plausible that the competitive governance situations theorized by the Ostroms and their settings conceptualized as “polycentric” engender a sufficiently powerful competitive dynamics to justify the use of the “Austrian” heuristics. Hence this view, once extended and calibrated to public and non-market settings, seems to the appropriate context of the concept of public entrepreneurship. The process may be less effective, less dynamic, further from equilibrium than in the case of the market. Yet, polycentric systems, via competitive governance may create the forces and mechanisms pushing towards equilibrium through a dynamic, equilibrating, adjustment process. The Wicksellian equilibrium may never be realized but the tendency should nonetheless be more or less present as long as the minimally supportive institutional environment is in place. While the end result of this process will never actually be a stable most efficient pattern of organizational configurations, polycentricity still predicts a continual search for more efficient ways to perform. We may easily conjecture that the more a system encourages initiative and decision, the more productive public entrepreneurship will emerge, as long as we stay within the rules of the game. This tendency itself is the stable outcome and it is in this sense that we can speak of a structural trend towards efficiency.

We are now in the position to restate succinctly the essence of the argument in the light of its latest elaboration: the Ostromian approach defines and analyzes public entrepreneurship as a phenomenon emerging in the specific environment of a competitive governance system of a polycentric nature in which the social mechanisms at work have at least a minimal tendency towards Wicksellian efficiency. In such systems whose operations are best captured through “process” competition theory,

entrepreneurship manifests itself in multiple ways: public, private and mixed forms that generate a diversity of initiatives and arrangements. The state and state-based arrangements are thus competing to other non-state (market, non-profit, voluntary organizations). The analogy with the standard market process is thus warranted. Given a minimal set of favorable conditions, a dynamic process of entrepreneurial adjustment and innovation is set into motion. The process itself is always imperfect and fallible. Yet when certain minimal conditions are in place, its emergence engenders a sufficiently forceful drive towards a form of Wicksellian equilibrium. Last but not least in this approach entrepreneurial action is pivotal: it is both a driver and a consequence of this process. That allows us to describe the relevant competitive governance phenomena using the Schumpeterian and Kirznerian models and thus to fully and robustly connect the Ostromian perspective to the mainstream entrepreneurship literature.

## **Implications and Conclusions**

The Ostroms' work opens up a deeper and richer perspective on public entrepreneurship and, by extension, on the relationship between entrepreneurship and public governance systems in general. As such it identifies a crucial missing link between political economy and entrepreneurship studies. Its thrust resides in more than the observation according to which in order to describe the nature of entrepreneurial endeavors, one needs to describe the political-institutional environment itself, the functional relationships between institutional arenas and the social actions that give structure and meaning to those endeavors. The Ostroms' concept of polycentricity converts that observation into a viable theoretical instrument and takes the discussion to a new level. We are thus led to a more systematic understanding of the dual relationship between entrepreneurship (in its multiple facets) and the institutional structures that define a public administration or governance system, as well as the processes emerging from that interaction. Seen in this light, public entrepreneurship doesn't seem anymore a second hand entrepreneurial manifestation, an imperfect and struggling entrepreneurialism in an uncongenial setting. It is part and parcel of modern pluralistic governance systems. Its role is pivotal: Given a set of minimal conditions, including the relative openness to entry and exit across domains and jurisdictions, as well as some room for rivalry, contestation and voice, public entrepreneurship emerges a major driver of change and adaptation.

The second set of lessons and insights brought to light by our exploration of the Ostroms' views relates to the very problem of conceptualizing and theorizing entrepreneurial actions and situations. We are led to the observation that "entrepreneurship" may be a label for a type of institutionally contingent and composite phenomena. "Entrepreneurship" seems obviously more than a set of psychological or behavioral features of social actors and more than events and incidents (of discovery, creativity, invention) of a significance to be more or less arbitrarily determined *ex post*. To call something "entrepreneurship" (be it public, private, social or political) requires more than an appeal, a showcase of acts of invention, creation, discovery, alertness etc. The notion evokes a structural context, a specific institutional configuration that allow us to assign a phenomenon to the class of instances entrepreneurship. Not any "context" or description of it serves the cause of entrepreneurship and its analysis. The "context" has

mainly to do with multiple supply and demand centers, their various forms of competition, efficacy in purposeful, goal driven instrumental rational actions, a systemic tendency towards efficacy induced into the system, and a general tendency towards (a broadly defined) equilibrium. In the absence of all these, it makes sense to speak only of “innovation,” “discovery,” etc. To qualify the latter as “entrepreneurial”/“entrepreneurship” requires to evoke at least some of the aforementioned elements. To detach the elements from the concept, to reduce it to attitudes and motivations, to psychological traits or actions related to them is to void the concept of its very essence.

In brief, following the Ostroms and extending their views one may be able to articulate an approach in which public entrepreneurship is studied as a compounded phenomenon, composite social fact in which a structural dimension (described in precise economic and social theory terms) is combined with a psychological or behavioral one. Given the fact that the dynamic, dialectic element is unavoidable, that leads to a process perspective. That doesn't mean that other perspectives that focus on psychological features, attitudes, behavior, action and events are not legitimate. It means that the Ostroms' inspired approach draws attention to a different angle, a complementary and perhaps more comprehensive and systemic approach. (....)

To sum up, the Ostroms' case for the study of the entrepreneurial function in political processes and governance systems is rather compelling both on its positive theory and normative dimensions. This chapter elaborated that case by going back to the Ostroms' work on polycentricity and public economies and showing how they opened a possible conceptual avenue towards the integration of the entrepreneurial function in political economy theorizing and through that towards the analysis of self-governance systems. As such it has only touched the surface of a rich territory awaiting to be explored at the boundary between social science analysis and normative theory. The next chapter will make a step further by focusing on the collective dimensions of public entrepreneurship.