

REVIEW OF
*PRIVATE GOVERNANCE:
CREATING ORDER IN ECONOMIC
AND SOCIAL LIFE*
BY EDWARD P. STRINGHAM
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JAMES SELLARS

Private Governance by Peter Edward Stringham is a refreshing expose and an important contribution to the field of economic thought. Stringham shows that Private Governance can be both, more efficient and more effective and can provide solutions to business problems without government coercion or interference. He brings a series of historical research that proves that Private Governance is alive and well in the world, and far more pervasive than most people even know. The most important insight the book reveals is, that private governance will find a market means to solve the problem often before it occurs. Stringham offers us some stimulating inspiration to question the status quo of economics thought, and continue to seek free market solutions to business problems rather than hope for a government to impose more rules and regulations on society.

I hope you enjoy the book review of Private Governance by Jim Sellars.¹

Stringham's work is well organized and full of historic examples of how the free market has policed itself much more effectively than is possible under the coercive control of government. The very idea that government is not needed in such matters as

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policing communities or regulating international trade seems preposterous until a careful review of this book is completed. Following a review of this book, the idea of private non-governmental governance begins to be seen as the only way it should be done. Stringham shows how history teaches that when governance has been private, created by the actors involved, it was for the betterment of all. It turns out that private governance is the only effective way to provide controls that are both practical in that they actually work, and practical from a cost point of view. These are the exact parameters used by economics to determine if a system is sustainable, efficiency and effectiveness earn a system market support. This book is an inspiring look at the 'unseen beauty of the cooperative abilities of mankind' and the markets generally, when left to develop free from predation of public intervention and control.

Stringham starts with the early stock market of 1750's London. The government had ruled it would not hear cases at court that involved the trading of stock. Thus, legally there was no recourse for the investor who is abused by his broker or the counter party to a trade he enters into. Stringham paints a picture of a poor investor abused by a crafty but fraudulent counter party to a trade and suggests that one could easily think that such abuses as fraud would be common place, in the absence of any kind of governmental control. It turns out-Stringham was able to show - that in fact the occurrence was very rare. Why? Because in the absence of external courts the brokers themselves formed exclusive clubs and rules designed to promote and protect the investment industry they were working to create and improve. Each club allowed only those brokers who met the club requirement of honesty, and fair dealings. «My word is my bond» became the motto of the London Stock Exchange the organization that grew out of the earlier coffee house clubs.

In modern times PayPal and eBay are organizations that provide payment processing for millions of transactions worldwide of a very complex nature, without any involvement by government. This is a case of private governance working on complex issues policing itself without the need or encouragement of a public government. Private Governance relies on an hypothesis that holds that while fraud and misconduct are pervasive, so are the private

solutions, that private governance is more common than most people would think, few people even notice it at work, and as such the non-violent, non-coercive methods are highly undervalued. This work stands in contrast to previous works, Gallanter(1981) and Williamson(1983) cited by Stringham that held that government control and public «legal centralism» are absolute necessities of the workings of the world and the market. Stringham points out that the thesis of these works mentioned here, «the protection and enforcement of contracts through courts and civil law is the most crucial need of a peaceful society, without such protection no civilization could be developed or maintained», is flawed. He suggests that the truth is actually the opposite, «like it or not, often government law enforcement is absent, too costly to use, or unknowledgeable about or uninterested in protecting property rights or contracts».

Stringham points out that government is often the organization that stifles economic productivity through it's slow moving, reactionary policy, while left to itself the free market pricing system that Hayek once called a «marvel» will bring forth a beautiful order in the markets, through the goal of providing value and prosperity for all through the market interactions. The «invisible hand» analogy of Adam Smith, is seen to come to life in this work, as more and more Stringham draws the reader to the conclusion that markets are where they are today, the result of underappreciated coordination mechanisms, such as the pricing mechanism, made possible by private governance.

While most would believe that government is needed to protect property rights and enforce contract, Stringham guides the reader to the development of tests that question when government intervention may not work. He lists them as follow;

1. Do regulators, the police, and courts have the ability to solve the problem in a low-cost way?
2. Do regulators, the police, and the courts have the knowledge to solve the problem? and
3. Do regulators, the police and courts have the incentive to solve the problem?

A review of these points shows that almost without fail government involvement will bring with it much higher costs. The facts dictate that government usually doesn't have the specialized knowledge to solve the problem and usually makes matters worse by trying and finally government doesn't have an incentive or motive to solve the problem. On the other hand, Stringham reminds us that anytime there is an unmet need, we should ask will such a need be met by the private sector? History as well as theory teaches that an unmet need (if a solution exists) will be found by the free market, through a process of market opportunity leading to discovery. The invisible hand again at work perhaps? The contrary argument is that the 'shadow of the state' with the threat of fines or imprisonment is necessary and would be enough of a threat to control a matter, deemed unacceptable in society, but our author reminds us that drug use continues in spite of the shadow of the state, both in society and even in prisons, where government should have complete control. Fraud continues even though it has been illegal since men began doing trades. Litigation doesn't work either, assets get tied up, it takes months typically and costs vast sums to get a hearing and resolve a matter, so more often it simply is not used in the vast number of market conflicts. When the regulators, police and courts can't solve a problem in a cost-efficient manner, an unmet need exists, and we only need await a private solution.

When the market creates a complex trading vehicle and there begin to be issues of concern, we would turn to government for some remedy, but do the government officials have the knowledge or training to understand the complex trading tools? Typically, the answer is a resounding no. The market provides feedback in the form of profits about whether the firms are meeting a consumer need, in what Hayek described as a discovery process. Ludwig von Mises said that without markets, central planners can't determine the effectiveness of the allocation of resources. Stringham calls on historical evidence to point out how even in Amsterdam in the 17th century as markets began to emerge complete with forward contracts and options, government could do little to control or even influence the trading. When the government outlawed certain forms of forward contracts and options, as a supposed perversion

of trading likened to gambling, the market ignored the ban knowing that the regulators didn't understand the trading tools and couldn't identify them anyway. Government was ineffective by virtue of their lack of knowledge. When, due to a lack of knowledge government, police and courts are unable to determine what steps could augment or hinder markets, there exists an unmet need.

San Francisco is the next example Stringham uses to illuminate the validity of the tests listed above. Merchants to this day hire police privately in the «City on the Bay». Back when the California gold rush was running wild the police were a greater risk than the thugs they were to control. Merchants grouped together and hired security privately. From that point on merchants had protection for their enterprises. The public police force has to allocate their resources like every other entity; clear a vagrant in front of a merchant's store or try to deal with priorities of violent crime and other more important and demanding issues? The idea of clearing an unwanted vagrant often does not get a response from the public police. Here again was an unmet need awaiting a solution. Police lacked incentives to respond. So the private sector took up the unmet need.

When the opportunity to find solutions is given to the private sector, entrepreneurs are encouraged to seek creative solutions, and better ways to serve market consumers. Thus San Francisco was divided into «beats» where privately hired police services patrolled the alleys and streets of the beat to provide security for the subscribing merchants. Throughout history government has a track record of undermining private property and interfering with markets, but even if we assume government is beneficent, they often can't meet the needs of the market, and thus arises the need to provide a private governance solution. Private governance exists because government is not a «deus ex machina», waiting at the ready to solve every problem we face.

Alternative dispute mechanisms began to spring up in response to a market need to solve unresolved disputes. What emerged was an agreement to arbitrate. Soon there were judges and specialists that would schedule a hearing quickly and render a ruling in a timely manner at a low cost to provide a solution where there had

existed none. The parties to such agreements would be able to set the rules by which their conduct was judged, the procedures that would be used and even the sorts of specialists who would act as judges in the matters. Private parties are mutually able to hire private judges who are experts in the disputed field and who will adjudicate in a way that the parties appreciate.

As well, the rather new invention of derivatives in markets, which are the most sophisticated and largest markets in the world with a notional value far in excess of the global GDP multiple times over, were private creations. Although they are wildly misunderstood, and have been vilified, these extensive new property rights, collateralized debt obligations, credit default swaps, and other investment instruments work remarkably well at mitigating risk and expanding the scope of markets. The hypothesis is that problems like fraud are pervasive, but so are private solutions. Mechanisms of private governance are much more powerful than is commonly thought. Everyone agrees that such private governance would work with small groups but people tend to defer to the need for government. Stringham show us that this is not a given at all. He quotes, Spinoza (1670), «he who tries to determine everything by law, will foment crime rather than lessen it».

And so the discussion goes on; Epstein (1999) comments «Under its classical liberal formation, the great social contract sacrifices liberty, but only to the extent that it is necessary to gain security against force and fraud». Epstein suggests we would be «naive visionaries» to «believe that markets could operate of their own volition without any kind of support from the state». Even Mises (1972) is —quotes by Stringham as holding that «The state is an absolute necessity since the most important tasks are incumbent on it, the protections not only of private property but also of peace, for in the absence of the latter the full benefit of private property cannot be realized».

The counter argument is that even as the entrepreneur looks for better ways to serve the client so also the private governance provider is encouraged to seek better ways, creative solutions, to serve its customers. Just as profit lures the entrepreneur, the providers of private governance are lured to find better ways to protect property rights and encourage market development. While government

has force and coercion at the ready to control society, the private sector has many other means to influence behaviour and almost none of them involve force. Individual clubs for example have the ability to set standards that they would uphold with their rules and membership requirements. Golf clubs resist change in dress codes, membership is restricted or terminated when one violates the club rules of conduct. People join clubs voluntarily and can quit if they don't like the rules of the club. All are free to choose their relationships, their job, their religion, making voluntary association a kind of governance that can solve for many of the goals of a civil society. Private governance should be given a careful review, and a chance to prove its value.

Stringham offers a careful review of those common thoughts that would dismiss the concept of private governance over central government imposed controls. The usual belief is that the people preparing the system of private governance would arrange the rules in their favour, but the market response is, for whom does the actor provide service? If it is accepted that the rules favour the businessman to the disadvantage of his clients, the clients will migrate to where they are appreciated better. The suggestion that the government as a disinterested third party would be better suited to providing governance is one that Stringham maintains can be rejected. The more the parties to an agreement see incentives for cooperation the more likely they are to find an internal solution rather than using government to solve for a breakdown in their relationships with their business partners. People will opt into a private governance situation only when they feel that the experience will be positive. The market ensures that is must be positive or the service of the private governance would not be successful. Again Stringham quotes another researcher, Kukathas (2007) who writes, «The fundamental principle for describing a free society is the principle of freedom of association, and the first corollary is the freedom of disassociation».

Some argue that in larger groups people are less likely to behave. But realistically, clubs can organize in smaller groups if that represents a real challenge. Practically, however members of the local boating club don't become pirates as soon as they get on their boat and members of the Elks Club don't change from Jekyll to

Hyde, at the end of the bar. When clubs are set up with people of similar views and behaviours there is rarely any issues. The ability to remove unwanted patrons or evict a transgressing tenant from a property is the right of the organization, cashing the deposit cheque of the unruly tenant or suspending a member's seat at the NY Stock Exchange, is a better solution than a constant reliance on force and violence that is that tool of choice for government. Stringham suggests that «if the mechanisms of private governance such as exclusion can eliminate the need for physical punishment or incarceration in some circumstances, then they should be viewed as quite liberal».

Our author goes on to explain that over the centuries, economists have discussed the benefits of markets over other forms of government compulsion and control. Adam Smith (1776) showed how markets create incentives for cooperation and honest and reliable trade. Carl Menger (1871) showed how supply and demand can coordinate without central control, and Ludwig von Mises (1920) showed how market prices, profit and loss, can communicate whether something is worth doing or not, and Fredrick Hayek (1948) showed how price systems in a free market can coordinate the activities of millions of people through a discovery process that shows what people want in the market, without any central control whatever. Economic analysis can be applied to governance just as easily, as a product that can be supplied and purchased voluntarily. Incentives abound that drive producers to improve and grow the service offerings they make available to customers, at lower costs and of better quality than that offered by a compulsory, monopolistic, central government. Often enforcement mechanisms are not even necessary, in that as the risk is better evaluated the vendor can price the risk into his product much in the way that a lender adds to the interest rate he charges to compensate for a higher risk exposure.

I MARKETS WITHOUT ENFORCEMENT

In the year 1614 in Amsterdam, the East Indian Company was making 100% profits on boat loads of riches from the east. Investors who wished to cash out their investments had no means, as the business was an ongoing venture with more and more ships sailing off to India. Without any government direction or control a secondary market in shares opened. Traders applied forward contract and short sales that they had learned in the commodity markets to the new trade in interests in the East India Company shares. Economists such as North (1990) argue that «complex contracting in a world of impersonal exchange must be accompanied by some kind of third party enforcement». But in 17th century Holland governmental officials were not supporters of trade in shares thinking it too similar to gambling, and passed edicts against such forward contracts and short sales. Despite the prohibitions a sophisticated market flourished. The fact is that whether it is 1600's Amsterdam or 2010 New York the market innovators are usually decades ahead of the governmental control apparatus. After 400 years of innovation governmental officials are just as oblivious to the workings of the markets.

Even when there are governmental controls in place they are often unusable or easily avoided, or too costly Stringham asserts. It is not reasonable to sue a restaurant if a meal is not up to standards, nor to sue a partner if the damages are low. Adam Smith (1766) pointed out that with repeated transactions as the goal, there is an incentive to follow through or people will not wish to do business with you in the future (reputation mechanism). The cost of using courts is prohibitive and time wasting, thus trading partners are already acting in a de facto state of lawless anarchy. With a bilateral reputation mechanism, when one party cheats, the other party boycotts him in the future, but when it is a multilateral reputation system, if you cheat, everyone boycotts you in the future. The governance is private and completely informal. Stringham goes on to suggest that these informal systems of governance prevail amongst sellers at eBay, restaurants, stores and almost all businesses.

Although there are economists that believe «a free economy thus requires a strong state». McNally (2007). In the case of the first modern economy there was nothing close to a strong state. In fact it was the freedom of action from a coercive and repressive government that lifted this first modern economy into a position of dominance enjoyed for years by the tiny Dutch State. It was the release of the Dutch State from the repression of the Spanish empire in 1648 that opened the door for economic freedom and prosperity. By the middle of the 17th century the Dutch had 16000 ships exploring every opportunity and half of all of Europe's total tonnage. Traders in shares developed a market in shares completely without the involvement of government, because there was a unmet need that required servicing. The government introduced edicts against short sales and forward contracts but they continued unabated. While the legal centralist would hold that such contracts, that are unenforceable in law would not happen, the fact is the very opposite, they were common place. «Like good economic heroes», Block (1976) «traders simply ignored the law and engaged in the mutually beneficial trade anyway».

Stringham draws on Adam Smith (1766) once more, who describes how forward contracts in England were not enforceable but that reputation, and continuous dealings (reciprocity mechanism) created incentives for people to deliver what they owe. «of all the nations in Europe the Dutch, the most commercial are the most faithful to their word... This is not at all to be imputed to national character, as some pretend... It is far more reduceable to self-interest, the general principle that regulates the actions of every man». Traders and brokers needed to act with integrity if they wanted to encourage a customer following. In the early markets of Amsterdam close scrutiny by government was not realistic, yet in the absence of legal oversight, bargains were upheld. The discipline of continuous dealings, honest and cooperative and accurate trading became the norm. Government did not create the rules so it is not possible to attribute the well run nature of the market to anything other than private governance. Reputations can be extended to others in that a good reference will encourage you to enter into a trade with a complete stranger, thus emerge mechanisms like the Michelin Guide of fine dining, or the reputational processes of

eBay where sharing of the transaction success of buyers allows one to rely on the likelihood that the vendor will deliver what was promised.

Stingham leads us through another example in the historic discussion of the emergence of the London Stock exchange in the early 1700's. The very interesting quote he used to introduce the chapter is from Voltaire (1733) who says that, «we see representatives of all the nations assembled there for the profit of mankind... as though they were of the same religion, and reserve the name infidel for those who go bankrupt». In London the officials were often unable to enforce basic laws, «they were an ungovernable people». A gin craze had started as well. Maybe the stimulus was the freedom or the booze, Peters & Stringham (2006) but London ended up with the most developed market in the world. Meanwhile as in Amsterdam, the government was not a fan of many of the contracts and none were enforceable at law. The officials banned brokers from the Royal Exchange so they set up shop in some of the local coffee houses. As the market grew it attracted many good but also many unreliable traders, keeping track of who were reliable became a challenge. Kirzner (2000) maintains, «one of the institutional prerequisites of markets is enforceability of contract and that without it the market cannot operate, and therefore those institutions cannot be created by the market itself». However historical research by our author, Stringham shows that the rules of the market did actually emerge from the market itself. The rules of the market came from the brokers who transformed the coffee houses into private clubs to create and enforce rules of behaviour.

In the case of the emergence of the London Stock Exchange, the exclusive club approach reduced the number of unreliable people taking part in the market, and created incentives for cooperation. The exclusivity of membership, acted like a forfeitable bond which made the unenforceability of performance at law an irrelevance. This showed that the rules of the game of the most sophisticated market in the world evolved from the market rather than from any kind of influence of government. The legal centralist assumes that problems must be dealt with by courts of law, but in the absence of that option the markets had to create a solution that made courts

unnecessary in the vast majority of circumstances that occurred at trade. Finally, the government had something positive to say about the Stock Exchange, in 1878 noting that the rules of the Stock Exchange «had been salutary to the interests of the public» and that the exchange acted «uprightly, honestly, and with a desire to do justice». The government report concluded by saying that the rules were «capable of affording relief and exercising restraint far more prompt and often satisfactory than any within the read of the courts of law».

Stringham's research leads us to the New York Stock Exchange which comes out of a history of coffee houses in lower Manhattan, similar to that of Amsterdam and London but has today emerged as the Cadillac of exchanges worldwide. Over time however Stringham shows that regulation and the burden of government intrusion has made the NY Stock Exchange less than able to encourage new developments and has restricted access to markets for entrepreneurs who wish to list properties. The result has been the development of new market solutions in the form of the alternative markets of the NASDAQ, and the OTC markets in the US and the emergence of the AIM (Alternative Investment Market) of London. The AIM has a much less arduous listing process that saves companies seeking listing thousands of dollars otherwise eaten up by the registration process at the NY Stock Exchange. The critics suggest that this watered down registration process will lead to a failure and fraud «race to the bottom», for the listing service, as the less stringent listing process will allow entry by less that reliable businesses.

The fact Stringham points out is that while there are some incidents they are rare and the growth and prosperity that follows better market access has been dramatic. So for example, one of the cost cutting methods of the AIM is to allow the prospective «lister» to hire a firm to do the compliance review prior to the listing being approved for the market. The review firm is referred to as a NO-MAD, (nominated advisors) and it does the due diligence to determine if the company can appropriately be listed. There is room for abuse in such a system of self-appointment of the watch dog firm, but again the effect of ongoing repeat business and reputation has been shown to exert a powerful pressure to maintain high stand-

ards of review. Each of these firms has high reputational capital that it does not wish to risk, Stringham explains, and they have created an AIM Advisory Group that provided feedback from all the participants in the market process.

The fact that the regulations are being rejected in the highly regulated markets of New York is evidence that their rules have become counter-productive. Stringham argues that if the rules were so great firms would flock to them, but in fact they are very costly and are driving firms away to competitors like the AIM in London. All this to say that historical research suggests markets will manage better if government is encouraged to keep its mitts off.

II

HOW TECHNOLOGICALLY ADVANCED MARKETS CAN WORK EVEN WHEN FRAUD IS LEGAL

Private Governance works in complex markets and in everyday consumer transactions as well. In 1999 a Silicon Valley start-up began to enable transactions between anyone with an email address. No expensive merchant terminals, or revealing personal financial information was required. Paypal began with a 1000 users in November and by December had 10,000 users. 100,000 by February and by April 1 million. While revenue topped \$48 million, in 2002, fraud was running to \$10 million per month. Theorists like Douglas North (1990) are convinced that «the returns on opportunism, cheating and shirking rise in complex societies. A coercive third party is essential». Stringham agrees with North in that the opportunity rises as societies get larger, the only problem is that those conditions, (large groups, technological sophistication, degrees of anonymity and interactions across political boundaries) also make the governmental enforcement almost impossible. Government solutions are often deficient and too late. Since government can do so little to enforce rules, it is as though fraud were legal. Paypal rather than capitulate, developed very sophisticated means of detecting fraud before it occurs. American Express, VISA, MasterCard, all face the same situations described by North, and

Stringham points out that they have survived by developing their own systems to counter illegal behaviour.

Stringham includes an excerpt from a speech of then Attorney General of the US Janet Reno, who listed the requirements of a government agency that would control and enforce against cybercrime. She said such an agency must have; 1. A round-the-clock network of federal, state, and local law enforcement officials with expertise in and responsibility for investigating and prosecuting cybercrime, 2. Computer forensic capabilities which are so essential in computer crime investigations, 3. Adequate legal tools to locate, identify, and prosecute cybercriminals, and procedural tools to allow state authorities to more easily gather evidence located outside their jurisdictions, and 4. Effective partnerships with other nations to encourage them to enact laws that adequately address cybercrime and to provide assistance in cybercrime investigations.

No wonder the government has not jumped at the opportunity to provide this kind of service. No wonder the governmental approach doesn't work. «The level of incompetence we dealt with was amazing», Peter Thiel, one of the early founders of PayPal stated thinking back. The assumption that technologically advanced markets could depend on government seems wildly unrealistic. The survival of organizations like PayPal depended on their ability to assess and manage the risk of fraud, by themselves. While legal centralists argue that the market needs to wait until the government can offer security, the private sector reacted by treating the problem not as one of enforcement but one of risk management. A loss from fraud is manageable just like any other risk of loss, there must be a cost associated and a way to insure against the loss. The market player who can provide a solution can market the service to other participants of the market, while those firms that can control the loss themselves can capture the revenue that would be lost, and add it to their bottom line. Therein is the beauty of the market, people who would never take such risks, can conduct business with assurance because the market will price out the cost of security into the cost of the transaction, making the risk of loss irrelevant once more. The most personal form of Private Governance

Police are absolutely necessary except when they are not, and as Rothbard (1973) points out, «Every New Yorker knows in fact that

he lives and walks the streets and not only Times Square, virtually in a state of anarchy, dependant solely on the normal peacefulness and goodwill of his fellow citizens». Stringham makes a great example of this point by drawing on the history of the nation of Georgia, formerly of the Soviet Union. The new president of Georgia was a former foreign minister of the Soviet Union, Mr. Shevardnadze, who told the people of Georgia who were fed up with the corruption of the former system and were protesting in the streets that they were risking causing a civil war. To which the people began to give roses to the soldiers, who in turn put down their guns and went home. The «Rose Revolution» was followed by a new democratic government, which promptly fired all the police, who had been a source of serious concern since they were underpaid and constantly assailing the population for money, in the form of fines or invitations for bribery. The new president, Mr. Saakashvili simply fired all the police. Did chaos ensue? Violence? Not at all. People actually felt safer since now there were no police to rob them.

The most personal form of private governance is our internal moral constraints. Such activities as manners, politeness, honesty, and trustworthiness are common examples of the internal controls that people impose on themselves, without any pressure from government. Most economists ignore such phenomena attributing all control on some external force or the threat of coercion. We cannot rule out that personal control may be the most important form of control a priori, Stringham suggests. Thus, we have corporations and clubs alike using screens of conduct and reputation to ensure that the employees or members of the organizations are of a like mind as to the proper way to conduct themselves. Adam Smith (1786) writes, «Without this sacred regard for the general rules of morality there is no man whose conduct can be much depended upon. It is this that constitutes the most essential difference between a man of principle and honor and a worthless fellow. The one adheres on all occasions steadily and resolutely to his maxims, and preserves through his whole life one ever tenor of conduct. The other acts variously and accidentally as humour or interest chance to be uppermost». Stringham shows his sense of humour many times through this work, and here he raises the discussion of

the decision making that separates the honest and moral from the criminal. The person with a conscience does not want to be burdened with thoughts of «How do you sleep at night? Or how can you live with yourself?» And as such avoids behaviours that would cause them to suffer such internal rebuke, but he suggests, «of course psychopaths, police, and politicians don't suffer much over morality». Because individual morality or self-governance lies within, it is harder to observe, but not impossible. Research in economics, psychology, and anthropology indicates that it does exist, and is important. It turns out that people have a built-in bias to want to cooperate. The conclusion is that individual self-governance is one of the most important sources of governance of them all.

III WHEN THIRD PARTY REVIEW IS NECESSARY

Stringham sets the stage here with an example, a ship is in distress in peril of sinking, a nearby ship comes to the rescue and while the captains are discussing, (read wasting time) how the salvage will be handled, the ship sinks losing the cargo and ship entirely. The solution again emerges from the market, in this case there is a Lloyds of London standard agreement that calls for immediate rescue and salvage to be followed by a later pre-agreed process of adjudication towards dividing the spoils of the salvage equitably. The adjudication is conducted by design by local experts selected by the parties involved rather than go to the courts or calling for a governmental official to intervene. Like other cases of private governance, the greater the potential need the more likely that private parties are to arrange for the private governance. Competing courts in England, Adam Smith (1776) reports, «led to superior dispatch and impartiality».

Private adjudication agreements are common in the market where settlements of minor disputes are much more efficiently handled privately than when taken to court, a process that is costly and slow. We have all signed an arbitration agreement with our

stockbroker, credit card provider, and cell phone carrier, as both small matters and large are better settled quickly and efficiently by private means than through the government offerings. Common use of private arbitrations has transformed the process from a legal question to one of business where the motive is to better serve the users, both buyers and sellers in the market. Sussman & Wilkinson (2012) report that the «median wait time from filing to trial of civil cases in the US District court for the Southern District of New York was 33.2 months». The American Arbitration Association informs us that the time from filing to finish is 8 months. Which would seem more efficient?

Certain disputes are so particular and complex that the parties would rather hire an adjudicator from available experts in the field than to rely on a random judge who likely would lack the knowledge required to fairly solve the problem. Where North (1990) asserts that more complex exchanges require government enforcement, Stringham asks us to consider how the judges and jurors of a governmental court, are reasonably likely to understand the complications adequately, compared to an industry expert? The more parties can rely on private adjudication for fair, and efficient ruling in disputes, the less they need government courts. It is common however for people to feel that at the end of the day, private order should be only made possible by threat of government enforcement. As it turned out the insurance examples of arbitration were enforceable by government agreement, but the problem that emerged was that the courts would not enforce arbitration rulings that they were not involved in creating. In modern times this is the experience of business operating in China according to Stringham, the Chinese courts would not enforce any ruling not rendered in a Chinese court. Thus, again the market offered a solution, prevent the fraud before it occurs rather than relying on the courts to enforce any arbitration rulings created by private adjudication. Despite the problems, trade continues to grow between the parties involved with China. The private solution seems to have the problem under control and again completely without involvement of control of government.

IV
DOES PRIVATE GOVERNANCE WORK
IN THE MOST COMPLEX MARKETS?

In theory if you lend money to someone and they fail to pay it back you can go to the courts and get your money back. In practise, you can't get your money from someone who is penniless. Even in the case of foreclosing on a homeowner who fails to pay his debts to the lender the foreclosure can take months and the likelihood is that the lender loses 50% of his investment and receives a house he never wanted. In response to this problem the market has created a very complex set of property rights designed to relieve the investor from the risk of loss. They are variously called mortgage backed securities, collateralized debt instruments, credit default swaps and many other private security arrangements that essentially provide an insurance component to the original debt instrument. Many hold that these instruments are at the root of the market collapse of 2008. Warren Buffet (2003) stated «Governments have so far found no effective way to control, or even monitor, the risks posed by these contracts. In my view derivatives are financial weapons of mass destruction».

By 2008 the economic world was in crisis and the biggest losses were associated with these instruments. Formerly important organizations and great trading houses were on the floor in full collapse, Lehman Brothers was gone, Merrill Lynch and Bear Sterns were absorbed by commercial banks, the government decided to nationalize Fannie Mae and Freddie Mac, and AIG. Alan Greenspan, (2008) reported a flaw in his own ideology, «I made a mistake in presuming that the self-interest of organizations specifically banks and others was such that they were best capable of protecting their own shareholders». Cable news (2008) reported that the 43rd president of the United States declared, «I have abandoned free market principles to save the free market system». Stringham admits that private governance was responsible for managing the risks and asks, «Is private governance something that worked in more simple times but is ill equipped for more sophisticated markets of today?»

These «lack of regulation caused catastrophe» and «regulations will prevent it the next time» arguments although widely held are

actually centuries old. They were heard after the first decline in the shares of the Dutch East India Company, in 1609, they were heard again after the South Sea Bubble of 1720, and following the market crash in America in 1929. We must remember that no one ever designed the market to avoid rising and falling stock prices. Private Governance helps people deal with counter party default risk, but not all risk associated with market declines. Stringham makes the case that the derivatives; collateralised debt obligations, credit default swaps, and other advanced market instruments were actually great innovations that to the contrary reduced the damage of the market crisis from being much worse.

The first point Stringham makes is that when financial investment vehicles drop in value this is not an indication of failure on the part of Private Governance. The net worth of Americans declined from 2007 to 2010 and has since recovered. Investments in mortgage backed securities have also turned out well. This would indicate that rather than fraud it was a general market decline the led to asset valuation declines. The second point Stringham makes in this regard is; when the value of firms' portfolios are intertwined and the perilous position of one firm can affect that of another, this does not indicate a failure on the part of Private Governance. When contracts like credit default swaps enable one firm to hedge against default, then the firm that received payment to assume the risk must do so. Credit default swaps did reduce the risks for the firms that bought them, and more prudent firms even bought a second hedge in case the first firm failed to be able to cover all the loses.

Third, when firms or individuals chose not to buy private governance and subsequently run into problems, this is not a failure on the part of Private Governance.

While governmental officials were saying, «Why me worry?» as the markets teetered near implosion, with Federal Reserve Chairman, Bernanke (2008) saying, «the government-sponsored agencies, GSE, are adequately capitalized. They are in no danger of failing». And the former chief economist of the World Bank, Joseph Stiglitz, was saying, «these results regarding the risk-based capital standard are striking; they suggest that on the basis of historical experience, the risk to the government from a potential default on

GSE debt is effectively zero». Meanwhile firms on Wall Street were buying default protection through private governance offerings. Firms on Wall Street felt that the Freddie Mac and Fannie Mae, were precarious and they wanted assurance and protection in the form of credit default swaps. Meanwhile, Allan Greenspan said, «The United States can pay any debt it has because we can always print money to do that. So, there is zero probability of default». It is interesting to note that the thought of an organized default was discussed during the recent presidential campaign. The possibility of default is certainly higher than zero that Greenspan suggested. What we see is firms being much more prudent than the officials in charge and responsible for assuring market stability.

Some might suggest that the Madoff fraud is proof that the market needs governmental oversight and control. Madoff was a fraud, Stringham assures the reader, but the government, SEC, with a \$1 billion budget for such things as investigations of questionable practises had been given reports that the whole mess was a Ponzi scheme, and yet it continued for years right under their noses. The conclusion again speaks to the theme of Stringham's book, the SEC concluded, «that because of the inexperience of the enforcement staff and the lack of understanding of equity and options trading, they did not appreciate that Madoff was unable to provide logical explanation for his incredibly high returns». The lesson is that the government simply lacked the knowledge or the incentives to notice this massive Ponzi scheme. An important point that our author makes is that there were many mechanisms of private governance that could have prevented such fraud but the investors chose not to defend themselves. If anything with the government agencies investigating Madoff and concluding that there was nothing amiss, private governance faced a more difficult challenge because of government involvement than would have been the case. Likewise, the housing bust would not have been so severe had government not kept interest rates so low for so long, inflating a bubble only to reverse course and raise rates 425% causing an avalanche of defaults amongst the subprime borrowers leading to the bust that followed.

Our problem as described by Stringham is that we can be sure of one thing, 1. No matter how much government regulations ex-

ists, or how much government contributed to the crisis, government will blame the next downturn on the free market and the lack of regulations. 2. Government will implement a new set of regulations that will be more onerous and do nothing to prevent the next economic downturn, leading back to point #1. An escalation of interventionism in society is similar and was also described by Ludwig von Mises in 1929 in his *A Critique of Interventionism. The Relationship between Private and Public Governance*.

Does the state help or crowd out good governance? Stringham asserts that although the legal centralists hold that «the state creates and preserves the environment in which the market economy can operate». Mises (1949) the fact is the government knows very little about things like art fraud for example, the solution is Private Governance, or in the words of the New York Times, «the police and buyers mostly rely on the art market to police itself». Buyers of fine art use markets like Sotheby's because they have protections built into the listing price that includes a five-year money back guarantee. Such assurances are costly, but they make the market more attractive to clients of the brokerage houses. Buyers who would like to operate in less secure markets such as the governmentally run Poly Auctions of mainland China face a much higher incidence of fraud. Yes, Stringham points out to all you legal centralists, governmentally regulated markets may have orders of magnitude greater levels of fraud than privately governed ones. Private governance always functions but it functions with much less efficiency the more it is hobbled by government.

«The home of laissez-faire is being suffocated by excessive and badly written regulations». Patricof (2011) in reference to the weakening competition in the US market. «And these regulatory burdens are turning up in many different markets, the mounting pile of regulations forced the IPO market to shrink and that since 2001 the number of IPOs in England has exceeded the number of IPOs in the US for the first time in decades». Stringham raises another «canard» when he suggests that readers could find an abundance of stimulating reading by tackling the Code of Federal Regulations, at 150,000 pages and a rate of consumption of 100 pages per day you could finish the work in five years given that no new regulations were added during that time. People working in the field of

business or market compliance are reported by our author to not wish the burden of the regulations on their worst enemy. The most harmful interferences came with World War I, when the London Stock Exchange was closed and later opened under government regulations that forced British investors to sell foreign investments in favour of British investments particularly British bonds. The result of putting governmental pressure on the market was to drive investors away. Shortly thereafter the NY Stock Exchange became the largest market in the world. In this example the government interfered with private governance with a view to adding to its own revenue at the expense of the investing public. Hayeks' predictions were proving true as money fled to where it was better welcomed.

In another example Stringham tells a somewhat funny story as he describes the entrepreneurial adventures of Jimmy Tebeau a member of the Grateful Dead, a famous alternative rock band of the 70's. It appears that Jimmy bought a 300 acre piece of Missouri forest land and set up a venue for music festivals employing hundreds and adding millions to the local economy. He was applauded by the Missouri legislature for his contribution, and his, «entrepreneurship and creativity that helped to broaden and deepen the economic foundations of local communities and neighbourhood». Stringham asserts that Jimmy also happens to live in a country where 100% of the presidents of the past 20 years have used illicit drugs, as many thousands of guests, to his music festivals did as well. To wit the government ascended down on this father of two young children throwing Jimmy in jail, confiscated his land and destroyed his business. «The public interest theory of regulations believes that government intervenes to help the public, whereas the economic theory of regulations discusses how regulations can be imposed to benefit special interests, private or governmental» Stigler (1971) «Other regulations are simply used to extract resources from successful enterprises». McChesney, (1987). In this stickup form of regulations the threatened party hands over resources or becomes a guest of the state. Stringham quotes Neuwirth (2011) where it is estimated that «fully 50% of the workers of the planet are engaged with the informal economy, this is another

indicator that governments are not creating beneficial rules and regulations and are more a hindrance on markets than a help».

V

APPLYING HAYEK'S INSIGHTS ABOUT DISCOVERY
AND SPONTANEOUS ORDER TO GOVERNANCE

Friedrich Hayek is well known for his ideas of spontaneous order coming from the pursuit of individual interests that bring about a complex outcome with no deliberate planning or design by anyone. Hayek also described the idea of the market processes being a discovery process of methods leading to better fulfillment of the needs of society. Stringham argues that the insight of this discovery process should be extended to governance as it faces the same circumstances as the market and so that optimal rules of governance can also be discovered. Hayek's idea that government was necessary Stringham holds is flawed, especially in light of all the evidence compiled in this work that shows that government more often than not interferes or stifles the growth of economic prosperity and development. Knowledge problems and accountability problems prevent a centralized government from providing rules and regulations that would hold up to Hayek's ideals. Hayek gave up his former idea that government should provide money (*The Denationalization of Money*) and Stringham argues that he should have given up his idea that government needs to oversee markets as well. Hayek (1976) wrote, «It has the defects of all monopolies, one must use their product even if it is unsatisfactory and above all it prevents the discovery of better methods of satisfying a need for which a monopolist has no incentive». Stringham continues, that Hayek should have consequently extended this argument of monopoly to governance. Accepting that governance is complex as other market phenomena should lead one to question whether governance should be monopolized or should be provided by the market itself.

In an important discussion of Hayek's evolved view of law and justice, Stringham draws the reader to an understanding of the principles that formed the law, a further discovery process found-

ed on generations of conventions and understanding of the rules of conduct that are just. In the end our author explains why Hayek should have embraced a market of private governance. Hayek holds that discovery processes in markets are positive and lead to real discoveries of better solutions to unmet needs of society. It implies a need for market like competition between organizations. This leads to a perspective that questions governmental monopoly of the control of markets or governance. The problem emerges when we realise that there is no feedback mechanism in a centrally controlled and dictated system of rules, to establish that the judges of the law or the system overall are doing a good job. In a monopoly and with no feedback mechanism how can the judge or the justice system learn if it is missing the mark or doing a good job?

Hayek suggests that the goal of the judge should be to discover the law, but the structure that he is provided is inadequate for the task. Hayek leads us to the need for market solutions and outlines the knowledge problem in the economy, but does not make the next obvious step according to Stringham which is to insist that like other goods and services, governance should be provided through market competition where the customer chooses the better solution. In a system of private governance customers can actually have, rather than a one size fits all approach, a set of rules that they actually value. Hayek worried about a society where rules were not uniform from one jurisdiction to another, suggesting that there would be too much confusion and people would be restricted in how they could interact, but he failed to see that this is what is going on all over the world already. For example; rules governing carrying guns can be different from one State to another in the US, as can the rules about drinking in public. In Europe the same differences exist from one jurisdiction to another but people there would be surprised that you could carry a gun at all and would be surprised that there is any restriction on where you may drink. Yet people travel without any incidents all the time. As discovery and competition promote positive results in markets so also should these learned lessons be applied to governance.

Rothbard (2000) describes «history is a race between state power and peaceful cooperation». Thomas Payne (1791) said it well when he states; «the landlord, the farmer, the manufacturer, the

merchant, the tradesman, and every occupation, prospers by the aid which each receives for the other, and from the whole. Common interest regulates their concerns, and forms their law, and the laws that common usage ordains, have a greater influence than the laws of government. In fine, society performs for itself almost everything which is ascribed to government». Such order comes about in spite of government. Markets are not the egg laid by the chicken of government but it's the other way around, markets came first and government followed. When we look at the first Stock markets we cannot say this is what government gave us, anymore than we could say that trade began because of policy and government. «Government is not the chicken that laid the egg of markets, but more like the salmonella, a pathogen associated with but not responsible for chicken or eggs». Hummel (2001) Private governance is responsible for far more developments of society than the examples listed in Stringham's book, and should be regarded as among the best achievements of humanity. Although faith in government is still widespread, it may be passing its apex. Stringham ever a comic, points out that confidence in Congress in the US has fallen to below 10% of respondents, higher than gonorrhoea but lower than cockroaches. Many people do not connect the dots between unreliable politicians and the inefficacy of the laws they impose, but the trends are changing. Conservatives do worry about the potential disorder of free markets, Stringham suggests that private governance will bring more order and much better order than what will likely come from any monolithic government imposed rules that are apt to be offered. Private governance solves problems seamlessly, with few people even noticing and so underpins economic exchange. It is limitless in its application, it facilitates cooperation, and it works in both the simple and the vastly complex markets of our modern world. It replaces coercion, and expands the scope of trade, and it should be seen as one of the most effective peace initiatives in the history of the world.

This work is an important book, not just because it introduces a discussion of the value of Private Governance, which is very considerable indeed, nor that it makes a careful investigation of the historical record to show that Private Governance has been the practice for hundreds of years. It is important because it reverently

introduces a very rigorous intellectual discourse that encourages us to question the orthodoxy of the great minds of the Austrian School of Economics. While it is common place to quote the truly gifted thinkers of the past, Mises, Hayek, and Menger, Adam Smith and others great minds, both deceased and alive, Stringham asks us if we can follow the logic of what they proposed to its modern conclusion. This is the breath of fresh air that if encouraged will further vitalize our movement. From a social science looking ever backward at the geniuses of the past we can become a dynamic and relevant force of understanding and insight that can bring practical understanding to the world at large. While we know that the current thinking of modern Keynesian economics is missing the truths shared by the great thinkers of Austrian Economics, our message has been muted. Perhaps Stringham has thrown down the gauntlet that we might begin afresh to provide leadership to our world so confused by modern economic policies that don't work and begin to offer practical solutions to the problems that threaten our very civilization.