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As a student of private regulation, I was very interested in taking up Stringham’s book on private governance. I share with the author a fascination for how people can manage to self-organize and devise formal or informal rules for social conduct. While the laissez-faire, free market perspective of the author is very far from my own, I nevertheless read the book with interest. Indeed, the book elaborates on fascinating historical case studies of markets that self-regulate, such as the first stock exchanges in Amsterdam or London. These case studies are used as a cornerstone of the controversial argument of the book: that private regulation does not develop thanks to government, but, rather, in spite of it. Private governance, the author contends, emerges directly from markets, oftentimes before or despite governmental regulation, and is more effective than governments in dealing with market problems.

The book is divided in three parts. Part one, comprising the first three chapters, serves as an introduction, outlining how private governance is more prevalent in markets than we might at first think and how such governance actually creates order without much need for governmental intervention. Chapters one and two plot the author’s arguments in favor of private regulation against “legal centralism”: “the idea that order in the world depends on and is attributable to government law” (5). The book’s central premise is indeed that legal centralism is mistaken in thinking that governmental regulation is superior to private governance. Chapter three details the author’s understanding of private regulation as a club of sorts; for Stringham, private governance is best analyzed as a voluntary association, of variable size, and of homogenous people and organizations, that exclusively serves its members and excludes the use of a good (or service) from non-members. Given that club members will view acceptable behavior similarly, the club requires very little use of coercion
for members to follow its rules. Clubs, therefore, create incentives for cooperation among people with similar goals, without the threat of (governmental) sanctions.

Part two elaborates a series of historical case studies of the emergence and functioning of private regulations in various markets. Chapter four details the functioning of the world’s first stock exchange, where the trading of stocks of the East India Company in Amsterdam in the seventeenth century involved about a thousand traders. They did not rely on governmental rules to regulate the sale and purchase of stock; rather, the exchange relied on its status as a reliable forum for transactions, similar to contemporary markets where the reputation of the platform creates confidence in the underlying exchange, such as in the case of eBay.

Chapter five examines how the London Stock Exchange emerged at the end of the eighteenth century, where the first traders convened in private coffeehouses because the English government proscribed some types of stock trading in public spaces. Over time, traders elaborated for themselves complex rules to regulate their exchanges and membership in these coffeehouses. Stringham’s argument is that the stock exchange and its rules emerged from the market (i.e. the traders) as state intervention and prohibition prompted market actors to imagine new ways of trading and organizing this trade themselves.

Chapter six compares the New York Stock Exchange (NYSE) and the London-based AIM exchange founded in 1995 that only lists small firms. The chapter details how the NYSE historically developed strict rules for listings, whereas AIM has much more flexible rules. Nevertheless, the author underlines, less stringent rules do not lead to more fraud, and markets are able to adapt their rules according to the segment to which they cater.

Chapter seven examines how PayPal and other online financial firms had to devise complex ex-ante risk management systems (as opposed to ex-post governmental sanctions) to deal with fraud when they started their business. It shows how the industry constantly
assesses the risk of fraud and how the “price” of fraud is built in transaction fees, thereby circumventing burdensome reliance on governmental courts in case of fraud.

Chapter eight makes the case for a private police system. It draws on 1850s San Francisco, where government and hence security was mostly absent or ineffective (state police, Stringham observes, were themselves criminal). As a result, San Franciscans created a private security force that reduced criminality. The argument is that when customers pay for a service such as security (along with assurances as to this police’s ethical behavior), the private sector can provide as good (if not better) services than the government because it serves its customers, and only its customers, directly.

Chapter nine continues the examination of police, describing how Georgia abolished in one day its corrupt police force in the 2000s, thereby showing the importance of individual self-regulation and moral constraints (citizens did not turn on each other because of the lack of police). Stringham argues that, sometimes, external constraints on behavior are not necessary for collaboration. He maintains that we check people’s reputation in various areas of social life. He reviews different studies in economics, neuropsychology, and economic anthropology showing that we are guided by an internal moral compass. Stringham argues that clubs, including those that organize some economic activity, rely heavily on such perceived internal moral constraints for their effectiveness.

Chapter ten continues where chapter five left off: coffeehouses. The particular one taken up in this chapter is called Lloyd’s of London and, of course, tells the tale of the now well-known insurance market. Trading occurring at Lloyd’s has evolved out of a system of insurance born of older times; in particular, it was a mechanism not only where risk was shared among different actors but also a social venue whereby disputes over costly and important activities, such as naval salvaging, would be adjudicated after shipping accidents occurred. The chapter makes the case for private adjudication. Lloyd’s helps illustrate the
point that private regulation can enable faster, more flexible, and more customer-oriented results in comparison to formal legal channels. Stringham goes on to argue that, similarly, eBay privately and successfully adjudicates disputes between buyers and sellers on its online platform.

Chapter eleven makes the point that private regulation was not the cause of the 2008 financial crisis. This chapter examines different financial instruments (such as standard and synthetic collateralized debt obligations) and Stringham argues that the failure of the system was not due to these instruments, but rather to a general downturn (which may happen at anytime), a poor assessment of risks of some companies (but not others), and governmental intervention in financial markets. He sustains that argument by highlighting that some firms who invested in less risky instruments weathered the crisis just fine.

Part three concludes the book with three chapters that bring together the insights of the previous case studies. Chapter twelve looks at how governments can impede the appropriate functioning of markets. The author draws a parallel between supply and demand in product markets and the supply and demand for rules – which can also be determined as an optimum – and therefore minimizes the importance of governmental regulation. Chapter thirteen discusses, based on the work of F.A. Hayek, how markets competitively “discover” innovations that customers desire, but could also “discover” the most appropriate regulations to govern themselves. Chapter fourteen closes out the book, providing future research avenues for promulgating private instead of governmental regulation, and outlining how research on private governance can inform short and long-run policy.

This book is a great read for people who share the author’s free-market ideology. Readers interested in rich historical accounts of stock exchanges and their emergence will also find part two of the book rewarding. That being said, if one does not subscribe to the free market view—that governments and their regulations are, for the most part, a cumbersome
mechanism for social justice and order—then one will probably fail to agree with the author’s conclusions regarding private regulation. While the free market analysis is well-developed, the book could be further developed by acknowledging alternative perspectives on some key ideas associated with private regulation, such as the scope of governmental authority, the role of morality, and the demands of justice, to name but a few. For example, while the morality of conduct within private associations is addressed in chapter nine, it is very narrowly described as a set of internal moral constraints, and not examined in terms of broader cultural and social frameworks. Morality is assumed by Stringham to stem from (free) markets, without acknowledgement that this is a limited conception of the moral norms governing social life (see, e.g., Etzioni, 1988; Fourcade & Healy, 2007).

Moreover, the book offers an overwhelmingly positive take on private regulation. While this is not a problem per se, the author fails to acknowledge, for example, failures of private regulation (e.g. Quinn, 2009; Yue, Luo, & Ingram, 2013), or unintended and oft non-economic consequences that private regulation may create (e.g. Dingwerth, 2008; Whiteman & Cooper, 2016). Stringham also seems to be oblivious to the fact that public and private regulations sometimes reinforce each other (Short & Toffel, 2010) and that private regulation, in some cases at least, emerges because some sort of public regulation or governmental support exists (Bartley, 2007). To conclude, Private Governance is a free market analysis examining great historical cases that should have more carefully considered different perspectives on private regulation.

REFERENCES


