

Private Governance: Creating Order in Economic and Social Life.

Edward Peter Stringham. 2015. New York: Oxford University Press. ISBN: 978-0-199-36516-6, \$45.00.

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On October 11, 2016, the South Korean company Samsung officially recalled their Galaxy Note 7 devices for faulty batteries that caused phones to catch fire. In reference to the safety hazards of the device, an article in the *Wall Street Journal* lamented that zero federal regulations cover the inspection and approval of mobile phone batteries (Fowler and Stern 2016). Perhaps ironically, the authors wrote independent third party testing of electronic devices was available (e.g. Underwriters Laboratories), but Samsung chose not to use it. This decision ultimately cost Samsung billions of dollars in the short run in recall costs and lost sales, and may cost the company billions of dollars in the long run from a tarnished reputation.

Fowler and Stern's call for additional federal oversight of electronics would likely make Edward Stringham frown with disapproval, particularly since private and independent third party testing is already available for companies willing to pay for the service. It is the tension between reflexively assuming government is the only solution to society's ills and relying on private governance like third party testing that forms the heart of *Private Governance*.

Heavily drawing from historical case studies, Stringham meticulously outlines the theory of how private markets create social order, often with little fanfare or notice. He advances two goals. First, it should not be assumed that legal centralism, loosely defined as "the idea that order in the world depends on and is attributable to government law" (p. 5), is effective. Second, private governance, defined as "the various forms of private enforcement, self-governance, self-regulation, or informal mechanisms that private individuals, companies, or clubs (as opposed to government) use to create order, facilitate exchange, and protect property rights" (p. 4), is more ubiquitous and more successful than most realize. His analysis is a positive analysis of the performance of the two types of governance rather than a normative analysis of what government should be (though he makes normative conclusions throughout, particularly in the last section of the book).

Stringham divides his book into three distinct sections. The first sec-

tion outlines the basic theory of private governance. The second section details case studies showing how individuals and private companies solve governance issues, such as fraud. The last section closes with three lessons derived from the examples of successful private governance.

Stringham asks whether government has the knowledge, incentive, or ability to solve the problem of social disorder in a low-cost manner. He emphatically answers no, and therefore turns toward an alternative arrangement to sustain order. This alternative arrangement is private governance, which, to be fair, he never portrays as perfect. Just as “entrepreneurs will never invent every possible product” (p. 19), private governance will never solve all social disorder. Private governance is more effective and less costly than centralized governance in many situations. Private governance turns “legal issues into issues of risk management” making “the effectiveness, or ineffectiveness of a government legal system” (p. 229) irrelevant.

The theory underpinning his assertion of the superiority of private governance over centralized governance combines arguments from Mises’s (1990/1920) focus on competition and profit, Hayek’s (1945) insight into the importance of local knowledge, and Buchanan’s (1965) economic theory of clubs. Private governance has an advantage over centralized governance because profits encourage private individuals to find solutions to disorder. The greater the disorder, the greater the opportunity to profit. The profit motive encourages people to cooperate, and private governance arrangements allow people to join associations that meet their needs. This is in contrast to the one size fits all legal centralist equilibrium.

Each case study Stringham selects shows how private governance works in less than favorable circumstances. For example, Stringham explains how the world’s first stock market in Amsterdam developed even though many of the contracts traded on the exchange had no legal enforcement (chapter 4). In chapter 7, he describes how PayPal has facilitated commerce where the risk of fraud is high and many of the transactions are between parties who never meet. In all, Stringham shows how private governance works “in large groups ... among heterogeneous traders ... with nonrepeat interaction ... and for tremendously complex deals that take place through time” (p. 228).

Throughout the narrative, Stringham is merciless in his criticism of those he calls legal centralists, including four Nobel laureates who are

revered by free market economists. The particular scholars he identifies in this manner are Douglass North, the leading champion of the importance of institutions in creating social order; James Buchanan, the pioneer of Public Choice theory and notorious critic of the current political arrangement; Milton Friedman, perhaps the best known free-market economist to the general public; and F.A. Hayek, defender of free markets when so many invoked socialism. Stringham even spends all of chapter 13 explaining why Hayek did not follow the advice of Hayek! It is no wonder Stringham dedicates the book to “legal centralists of all parties” (p. vi).

These are not idle criticisms. Stringham’s case studies question North’s (1991) assumptions that centralized institutions are needed when there is limited information, nonrepeating interactions, and a large number of players. With respect to Friedman, Stringham asks why, if competition is important for efficiency in economic markets, the same would not be true for governance. In regards to Buchanan, Stringham asks why, if politicians are self-interested, wouldn’t judges be self-interested as well? For Hayek, Stringham asks why, if central planners do not have enough information to strategically plan an economy, would a top-down centralized legal system do any better? To Stringham, all legal centralists are akin to Adam Smith’s (2003/1776) man of the economic system, thinking they can rearrange society as they see fit.

Private Governance’s greatest strength is its use of case studies in bringing economic theory to life. Whereas many books, and far too many journal articles, use empirical techniques to convince the reader of the veracity of theory, the methodological choice of case studies is refreshing. While a case study approach invites the criticism that the author only selects the strongest of examples, Stringham’s breadth of examples should help quell such concerns.

Stringham’s style of writing is relaxed and clear, refreshing for a university press book. Sprinkled throughout the book are jokes, though his use of sarcasm may be a bit much for some readers. He shows that academic writing focused on theory can be accessible to the average layperson without losing needed technicalities.

The book also assumes that people are sinful, even if Stringham does not use these exact words. Government policymakers are self-interested and no government system, whether centralized or not, will create perfect social order. This clear thinking fits well with the biblical worldview

that humans are fallen, and because they are fallen, structure is needed to harness their passions.

For all the good the book accomplishes, *Private Governance* contains a serious, and in some ways, fatal flaw. Curiously, Stringham accepts the standard dictionary definition of government and never addresses what role government should play in society. Given his discontentment with centralized government, it is unacceptable not to address what government should do. This is problematic for four reasons.

First, how would Stringham respond to Aristotle's (1984) claim that humans are political animals and the state is a creation of nature, such that a person living outside of the state is an outcast? Private governance is not the same as the state. Perhaps Aristotle is wrong, but Stringham offers no explanation why.

Second, Stringham cannot hide behind the claim that he is offering a positive evaluation of government rather than a normative claim. The separation between normative and positive economics is artificial. Evaluating the effectiveness of government means that there must be some standard for comparison. Stringham is using some broad notion of efficiency as the standard. However, by choosing efficiency as the standard, Stringham is making a normative claim, a claim he should defend.

Christians do not have the luxury of avoiding the question of the role of government in society. Since government is ordained by God, presumably government has some positive role to play in society. At the very least, Christians should agree God ordained government to encourage good and punish evil (see Romans 13:1–7 and 1 Peter 2:14). While agreeing what the good is in certain situations may be difficult, even for Christians, not even considering the question leaves a void that must be filled. Stringham is silent on this important consideration.

Third, since Stringham reduces governance to risk management, it is probable that even the traditional view of government as a provider of public goods and corrector of market externalities tends towards legal centralism in his perspective. While policymakers have abused the traditional notion of government, and the traditional notion is ripe for critique, especially since there are probably no examples of a pure public good and the private market can do a good job internalizing externalities when transaction costs are low (Coase 1960), Stringham does not address whether this definition of government is acceptable.

Lastly, without considering what the role of government is, and by

reducing all government to a club good, how would Stringham respond to a situation like the establishment of Sharia or Halakah law within an existing society that embraces a more secular tradition? A parallel secular legal structure could also be problematic. It is one matter to consider different legal listing requirements for companies turning public (see chapter 6) and quite another if two legal structures in the same geographic area treat theft, rape, or murder differently.

In fairness, the scope of government's responsibility, the optimal size of government, and the potential for competing, overlapping governments are outside the scope of Stringham's core hypothesis. However, these are important questions deserving of answers.

Private Governance brings the invisible hand analogy of Adam Smith to social order. In doing so, the book is sure to stir controversy, if only because of the strong legal centralist mindset many people have. Economists interested in theory should appreciate the book for melding the insights from the Austrian, Public Choice, and New Institutional schools of economic thought into a unified and coherent theory of governance. Non-economists should find the case studies accessible and informative. The book would work well in a government policy class because it challenges the assumption that government must be centralized to fend off disorder.

The book is also a good starting point for highlighting the limitations of centralized government and promoting the successes of private governance. However, for the Christian, or anyone interested in a philosophical discussion of government, the book is incomplete and should be read only in conjunction with books that consider the normative question of what government is.

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