CATO Blasts Mercantilism

Written by The Daily Bell

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An Economy of Liars ... When government and business collude, it's called crony capitalism. Expect more of this from the financial reforms contemplated in Washington. Free markets depend on truth telling. Prices must reflect the valuations of consumers; interest rates must be reliable guides to entrepreneurs allocating capital across time; and a firm's accounts must reflect the true value of the business. Rather than truth telling, we are becoming an economy of liars.

The cause is straightforward: crony capitalism. Thomas Carlyle, the 19th century Victorian essayist, unflatteringly described classical liberalism as "anarchy plus a constable." As a romanticist, Carlyle hated the system - but described it accurately. Classical liberals, whose modern counterparts are libertarians and small-government conservatives, believed that the state's duties should be limited (1) to provide for the national defense; (2) to protect persons and property against force and fraud; and (3) to provide public goods that markets cannot. That conception of government and its duties was articulated by the Declaration of Independence and embodied in the U.S. Constitution. - Wall Street Journal Opinion

Dominant Social Theme: Markets need freedom.

Free-Market Analysis: CATO is fighting the good fight in Washington DC for libertarian causes, and this article by CATO contributor Gerald P. O'Driscoll is an outgrowth of that perspective. Driscoll is a senior fellow at the Cato Institute and his brief bio at the bottom of the article informs us that he has been "a vice president at Citigroup and a vice president at the Federal Reserve Bank of Dallas."

This is a pretty interesting article; its basic point is that regulation doesn't work and some other methodology must be found. In fact, this is a startling opinion to read in Rupert Murdoch's Wall Street Journal. If the modern age has a God, it might be said to be "regulatory democracy," and to question its fundamental assumptions is heresy. It's simply never done in the mainstream press - or hardly ever. Kudos to O'Driscoll. Here's some more:

The idea that multiplying rules and statutes can protect consumers and investors is surely one of the great intellectual failures of the 20th century. Any static rule will be circumvented or manipulated to evade its application. Better than multiplying rules, financial accounting should be governed by the traditional principle that one has an affirmative duty to present the true condition fairly and accurately - not withstanding what any rule might otherwise allow. And financial institutions should have a duty of care to their customers. Lawyers tell me that would get us closer to the common law approach to fraud and bad dealing.

Public choice theory has identified the root causes of regulatory failure as the capture of regulators by the industry being regulated. Regulatory agencies begin to identify with the interests of the regulated rather than the public they are charged to protect. In a paper for the Federal Reserve's Jackson Hole Conference in 2008, economist Willem Buiter described "cognitive capture," by which

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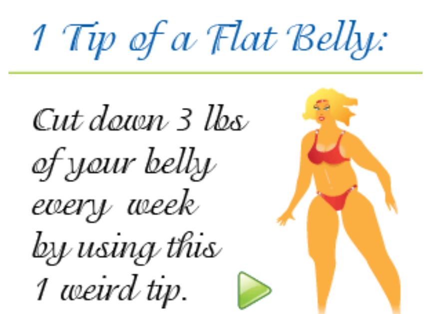

regulators become incapable of thinking in terms other than that of the industry. On April 5 of this year, The Wall Street Journal chronicled the revolving door between industry and regulator in "Staffer One Day, Opponent the Next."

Congressional committees overseeing industries succumb to the allure of campaign contributions, the solicitations of industry lobbyists, and the siren song of experts whose livelihood is beholden to the industry. The interests of industry and government become intertwined and it is regulation that binds those interests together. Business succeeds by getting along with politicians and regulators. And vice-versa through the revolving door. We call that system not the free-market, but crony capitalism. It owes more to Benito Mussolini than to Adam Smith.

The above obviously refers, in part, to "regulatory capture," which is a regular theme of the Bell's. In fact, we quite agree (and have written) that regulatory democracy is a difficult system to live under. The main trouble with regulatory democracy is that it constantly evolves. Woody Allen once compared a relationship to a shark - "It has to constantly move forward or it dies" and perhaps the same sentiment could apply to regulatory democracy.

In the United States and Europe, too, regulations are constantly being added and updated. The expansive nature of regulations is driven, ironically, by regularly dysfunction. Each failure generates more of them. Unfortunately, they only concentrate power with larger and larger entities that can afford the legal and technical advice to work around them. Entrepreneurs go out of business as regulations get more complex. Corporatism expands its dominance.

In some senses, totalitarian societies may be preferable to regulatory democracies in their latter stages because there is no overt justification for a totalitarian society, at least none that people living under its rule believe. (This may make such a system easier to remove.) But the advantage of a regulatory democracy, even when it has turned most authoritarian - from the point of view of its leaders - is that a goodly minority, or even a majority, may believe that the system has evolved in pursuit of "fairness" or some other chimera.

Of course in its latter incarnations, regulatory democracy, with its endless laws, ever-higher taxes and central bank induced inflation, can eventually evolve into the most despotic of practices. The article doesn't analyze regulatory democracy in terms of regulations' larger sociopolitical impact, but it makes additional points regarding solutions to regulatory democracy. Here's an additional excerpt:

Free markets depend on truth telling. Prices must reflect the valuations of consumers; interest rates must be reliable guides to entrepreneurs allocating capital across time; and a firm's accounts must reflect the true value of the business. Rather than truth telling, we are becoming an economy of liars. The cause is straightforward: crony capitalism. ... If we want to restore our economic freedom and recover the wonderfully productive free market, we must restore truth-telling on markets. That means the end to price-distorting subsidies, which include artificially low interest rates. No one admits to preferring crony capitalism, but an expansive regulatory state undergirds it in practice. Piling on more rules and statutes will not produce something different than it has in the past. Reliance on affirmative principles of truth-telling in accounting statements and a duty of care would be preferable. Deregulation is not some kind of libertarian mantra but an absolute necessity if we are to exit crony capitalism.

If we had any quibble with this article it would be, first of all, along the lines of the utilization of the term "crony capitalism." It seems to us that another term, historically more precise, would be mercantilism. In America, those who regularly deal in sociopolitical terminology seem determined to substitute their own words for words that already available. We don't understand why this is necessary. Somehow, for instance, America lost sight of what "liberal" meant in Europe; thus to use the term "classical liberal" in America often needs an explanation now.

Likewise, "crony capitalism" may have more of a meaning in America than Europe, though mercantilism has considerable potency in our opinion. We read this in the Library of Economics and Liberty: "In contrast to the agricultural system of the physiocrats or the laissez-faire of the nineteenth and early twentieth centuries, the mercantile system served the interests of merchants and producers such as the British East India Company, whose activities were protected or encouraged by the state."

Indeed, the process of mercantilism advantages some private interests over others. The United States, like Europe, has been moving toward a full-blown mercantilist-style system for some time now. Perhaps the system could be termed neo-mercantilism. It doesn't have all the formal elements of mercantilism (as regards government accrual of gold bullion, etc.) but it certainly has supported a strong relationship between a favored business class and the government itself

Another quibble: The article calls for a return to market-based truth telling and refers to low interest rates. Such rates are a function of the Federal Reserve and thus one might think the article is calling for changes at the Fed. Unfortunately, what they might be is unclear since the article makes no direct mention of the American central bank or its role in distorting prices.

The article DOES make use of a term of commercial and legal art, "duty of care." Wikipedia defines it thusly: "In tort law, (or delict in Scots law) a duty of care is a legal obligation imposed on an individual requiring that they adhere to a standard of reasonable care while performing any acts that could foreseeably harm others. It is the first element that must be established to proceed with an action in negligence."

The problem with such approaches, of course, (from a purely anarcho-capitalist point of view) is that one needs an "enforcer" to ensure that such concepts are properly adhered to, and almost inevitably

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one may end up with a regulatory authority once again. It would seem, therefore, based on this article and similar rhetoric - especially from CATO which seems to espouse "reasonable" libertarianism - that there is still, even within American libertarian circles, an impulse to distrust markets themselves, and their inherent disciplinary abilities. We would like to offer up the idea that the Invisible Hand itself is a formidable disciplinary device. Wouldn't a company that consistently misleads customers or investors run itself out of business - regardless of whether it was under an affirmative obligation to exercise a duty of care?

Conclusion: In the best of all worlds, money itself would be privatized through the adoption, perhaps, of free-banking and the resultant evolution of a private gold and silver standard. People would rely on competition and private (common law) to sort out grievances having to do with alleged malfeasance or commercial deception. Nonetheless ... to read such an article in the Wall Street Journal is a startling, given that it attacks (politely to be sure) regulatory democracy. For an article like this to appear in a major publication is certainly a step forward as regards the larger conversation about what has gone wrong in America and, generally, in the West.

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