REGULATION AS A MEANS TO SELF-REGULATION

"We dance around in a ring and suppose.
But the secret sits in the middle and knows."
— ROBERT FROST

Herbert Spencer's *The Man Versus The State* is prefaced with the pronouncement that "unless due precautions were taken, increase of freedom in form would be followed by decrease of freedom in fact."[1] Spencer was not the first and will not be the last to proclaim that the pursuit of freedom and liberty is the guiding principle for liberal democracy. But what do freedom and liberty mean — and how are they articulated and restricted by markets? In this essay, I draw upon the work of Herbert Spencer, Friedrich Hayek, John Maynard Keynes, and Joseph Schumpeter to examine how effective market regulation can advance freedom and liberty with liberal democracy as its ultimate goal.

Before we get to markets, it is essential to compare and contrast what liberty and freedom mean. In his essay, Two Concepts of Liberty, Isaiah Berlin delineates positive liberty from negative liberty. The aim of liberal democracy is the pursuit of negative liberty to produce an "area within which a man can act unobstructed by others."[2] However, this is not to say that the exercise of liberty within liberal democracies can be absolute, for the "liberty of some must depend on the restraint of others."[3] Mill advocates for absolute liberty in those parts of conduct for an individual "which merely concerns himself";[4] Berlin builds on Mills' conception of limited individual sovereignty to remark that an abrogation of liberty will result in the stagnation of civilisation and an absence of truth.[5] Spencer, echoes

[1] Spencer, Herbert. "Preface." *The Man Versus The State*. The Caxton Printers, Ltd., 1960, n.p.
[2] Berlin, Isaiah. *The Proper Study of Mankind: An Anthology of Essays*. Edited by Henry Hardy, Chatto & Windus, 1997, p. 191.
[3] Berlin, Isaiah. *The Proper Study of Mankind: An Anthology of Essays*. Edited by Henry Hardy, Chatto & Windus, 1997, p. 196.
[4] Mill, John Stuart. "Introductory." *On Liberty*. Longman, Roberts & Green, 1869; Bartleby.com, 1999. www.bartleby.com/130/.
[5] Berlin, Isaiah. *The Proper Study of Mankind: An Anthology of Essays*. Edited by Henry Hardy, Chatto & Windus, 1997, p. 199.

this conception of negative liberty — the freedom *from* — when he reminds his readers that liberalism "habitually stood for individual freedom *versus* State-coercion."[6] Hayek, too, averred this conception of liberty by defining it as "freedom from coercion, from the arbitrary power of other men."[7] The consensus between Hayek, Mill, and Spencer clearly demarcates negative liberty as the guiding principle of liberal democracy, in the absence of which tyranny reigns.

However, the relationship between markets and liberty is far more complex and not necessarily causal in nature. For the purposes of this essay, a market is both a medium of exchange and its sum total, i.e. the economy. Berlin writes of our "declining capitalist civilisation," noting that "the connection between democracy and individual liberty is a good deal more tenuous than it seemed to many advocates of both."[8] This is in direct contrast with Schumpeter, who presupposes a causal relationship for both liberty and democracy with the rise of markets, noting that "whatever democracy there was ... developed historically in the wake of both modern and ancient capitalism."[9] For Schumpeter, the rise of capitalism enhanced rationality, which enabled man to conceive of man being created equal in some form, and thence incorporated those negative freedoms in a manner that withstood the rational onslaught to produce a group of people concerned with the progress of man.[10] Both Berlin and Schumpeter recognise that the ancient world had freedom, unlike Hayek and Spencer, who believe that the freedom we enjoy today is a peculiar development of the modern world.[11] Regardless of the entity responsible for the

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[6] Spencer, Herbert. *The Man Versus The State*. The Caxton Printers, Ltd., 1960, p. 5.
[7] Hayek, Friedrich. *The Reader's Digest Condensed Version of The Road to Serfdom*. The Institute of Economic Affairs, 2001, p. 40.
[8] Berlin, Isaiah. *The Proper Study of Mankind: An Anthology of Essays*. Edited by Henry Hardy, Chatto & Windus, 1997, p. 203.
[9] Schumpeter, Joseph Aloïs. *Capitalism, Socialism, and Democracy*. Routledge, 2003, p. 126.
[10] Schumpeter, Joseph Aloïs. *Capitalism, Socialism, and Democracy*. Routledge, 2003, p. 127.
[11] Berlin, Isaiah. *The Proper Study of Mankind: An Anthology of Essays*. Edited by Henry Hardy, Chatto & Windus, 1997, p. 201.

endowment of rights upon man, Hayek, Spencer, and Schumpeter all believe in limited government intervention insofar as it advances liberty. Furthermore, it will be clear from an examination of the works of Spencer, Hayek, Keynes, and Schumpeter that markets do not regulate themselves in ways that advance liberal democracy. The question that remains is: to what extent must markets be regulated to ensure they advance liberal democracies?

Spencer, writing in 1884, addresses a long paean to the Liberals gone by that pushed the United Kingdom to, among other things, expand the franchise, banned slavery, culled the monopoly of the East India Company, and in general diminished "compulsory co-operation throughout social life and increased voluntary co-operation."[12] The market represents the voluntary association of man with other man and articulates itself as a rupture from the mandatory feudal system for the latter gave way to a class of freemen who were able to take their skill and labour where they pleased. The job of both markets and liberal democracy was to free man from restraint, and when the former failed to do act as an easing of restraint for the public good, it was the duty of government to do so. Markets were to exist on their own unless a grave market failure occurred, where liberty and the public good were at stake, and only then did Liberals have the imperative to intervene and regulate, such as in the case of Merchant Shipping Act of 1873, which gave "the Board of Trade power to fix the numbers of boats and life-saving appliances to be carried."[13]

Spencer's social Darwinism, however, marks a characteristic appearance in the following essay, The Coming Slavery, where he hypostatises the market for labour and the regulatory environment of

[12] Spencer, Herbert. *The Man Versus The State*. The Caxton Printers, Ltd., 1960, p. 5.
[13] Spencer, Herbert. *The Man Versus The State*. The Caxton Printers, Ltd., 1960, p. 13.

Victorian England and how creeping legislation has "generated in citizens the notion that everything is to be done for them, and nothing by them."[14] By making the supply of labour unequivocally dependent on welfare, the State "strengthens the tacit assumption that it is the duty of the State to deal with all evils and secure all benefits,"[15] resulting in a creeping monster. This *prodigium* would result in man labouring for the State without freedom from it; for Spencer, man then "becomes a slave to society."[16] Regulation, however, for Spencer is not *ipso facto* bad, for he admits that "no form of co-operation, small or great, can be carried on without regulation."[17] The totalising nature of regulatory activity and frequent excursions into the curtailment of citizens' liberties are what concerns Spencer, who insists upon the functioning of government to support the a relatively free market with standards and norms necessary for its propagation and continuation. Spencer concludes that excessive regulation and coercive taxation are both particularly detrimental to the nation and to the markets that function only in the absence of totalising power.

Hayek, in agreement with Spencer a mere 61 years later, finds a similar trend towards totalising State control. A competitive market is "*is the only method which does not require the coercive or arbitrary intervention of authority*,"[18] and while not every market was in perfect competition, the mere existence of the market where free men formed voluntary associations precluded an encroaching of governmental power in general. The recognition of distorting forces on the functioning of markets is important for

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[14] Spencer, Herbert. *The Man Versus The State*. The Caxton Printers, Ltd., 1960, p. 37.
[15] Spencer, Herbert. *The Man Versus The State*. The Caxton Printers, Ltd., 1960, p. 40.
[16] Spencer, Herbert. *The Man Versus The State*. The Caxton Printers, Ltd., 1960, p. 43.
[17] Spencer, Herbert. *The Man Versus The State*. The Caxton Printers, Ltd., 1960, p. 48.
[18] Emphasis as per original. Hayek, Friedrich. *The Reader's Digest Condensed Version of The Road to Serfdom*. The Institute of Economic Affairs, 2001, p. 37.

their correction, and he endorses the use of regulation, like Spencer, "to limit working hours, to require certain sanitary arrangements, to provide an extensive system of social services" in furtherance of competition.[19] However, unlike Spencer, Hayek believed that modern economies had create such wealth that:

> "There is no reason why, in a society which has reached the general level of wealth ours has, the first kind of security should not be guaranteed to all without endangering general freedom; that is: some minimum of food, shelter and clothing, sufficient to preserve health. Nor is there any reason why the state should not help to organize a comprehensive system of social insurance in providing for those common hazards of life against which few can make adequate provision."[20]

This intervention into the market for labour was a recognition of the larger structural problems that unemployment could produce. Hayek lived in and feared a world that was dominated by totalitarian forces: Russia was subject to the Communists, Germany to the Nazis, and Italy to the Fascists. All three shared a disdain of open and free markets and liberty in general, and came to power in the aftermath of economic crises that, without a safety net, produced a critical mass of voters who, feeling abandoned by liberalism, were ready to try alternatives where they bartered liberty for sustenance. Hayek supposes the role of regulation and law as forming the bedrocks of markets, arguing that the purpose of the State is "to create conditions in which competition will be as effective as possible, to prevent fraud and deception, to break up monopolies."[21] The *only* constructive regulation is that which furthers markets, which propagate private property — "the most important guarantee of freedom."[22]

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[19] Hayek, Friedrich. *The Reader's Digest Condensed Version of The Road to Serfdom*. The Institute of Economic Affairs, 2001, p. 38.
[20] Hayek, Friedrich. *The Reader's Digest Condensed Version of The Road to Serfdom*. The Institute of Economic Affairs, 2001, p. 59.
[21] Hayek, Friedrich. *The Reader's Digest Condensed Version of The Road to Serfdom*. The Institute of Economic Affairs, 2001, p. 38.
[22] Hayek, Friedrich. *The Reader's Digest Condensed Version of The Road to Serfdom*. The Institute of Economic Affairs, 2001, p. 33.

On the other hand, Hayek recognises that there are "certain fields where the system of competition is impracticable," and these are where the government should directly intervene, like the deforestation and pollution control, for these activities affect the public wholly.[23] Markets, left to their own devices, would not necessarily incentivise those results that were deemed to be in the benefit of all involved. But these exceptions prove Hayek's rule, for the decentralisation of economic power is essential to the system of checks and balances he prescribes to them, and as such he strongly proposes the government break up monopolies because they warp market forces. He concludes by noting that "a policy of freedom for the individual is the only truly progressive policy,"[24] and therefore the propagation of liberal democracy as we know it is contingent upon the State regulating markets to enable its actors to compete as perfectly as possible, for this is the best way we have to guarantee those negative liberties that we should treat as inalienable and refuse to barter to totalitarians of all shades.

Keynes, like Hayek, was worried about the looming spectre of totalitarianism and its realisation in parts of Europe. The aftermath of the Depression of 1929 had shown the abject failure of monetarist macroeconomic models and solutions, as epitomised in the policies of the US President Herbert Hoover, who was deeply averse to government intervention across markets and did little to prevent a further slide into long-term recession for three years, until the July 1932 Emergency Relief and Construction Act. Keynes understood that at economies with large numbers of people "involuntarily unemployed", "at the employment of a given number of men on public works will … have a much larger effect on aggregate employment at a time when there is severe unemployment."[25] Both the scale and intensity with which

[23] Hayek, Friedrich. *The Reader's Digest Condensed Version of The Road to Serfdom*. The Institute of Economic Affairs, 2001, p. 38.
[24] Hayek, Friedrich. *The Reader's Digest Condensed Version of The Road to Serfdom*. The Institute of Economic Affairs, 2001, p. 62.
[25] Keynes, John M. *The General Theory of Employment, Interest, and Money*. Palgrave Macmillan, 2018, p. 112.

the Great Depression hit worldwide economies showed Keynes the importance of the categorical imperative of increased spending as direct interventions as a necessary move to prevent the slide to totalitarianism. In his preface, Keynes admits that the economy is a series of "technical conditions"[26] that must be dealt with as such. He did not argue for the abrogation of classical macroeconomic models, but added a layer of nuance that addressed the variegations in business cycles that, as he rightly recognised, were structural and not isolated.

What Keynes astutely recognised was the appropriate level of regulation and intervention, which was no more than a scaffold and foundation for the market to function effectively within. He recognises both the conservatism and antisocialism implicit in his general theory:

> "… the foregoing theory is moderately conservative in its implications. For whilst it indicates the vital importance of establishing certain central controls in matters which are now left in the main to individual initiative, there are wide fields of activity which are unaffected. … If the State is able to determine the aggregate amount of resources devoted to augmenting the instruments and the basic rate of reward to those who own them, it will have accomplished all that is necessary."[27]

The Keynesian multiplier that he pioneered in this tractatus was both his cause célèbre and his magnum opus, for it is here that he understands that government spending can, especially during times of high involuntary unemployment, result in economic revitalisation through the multiplier of more than twice the original amount invested without causing price inflation. Even in the USA, which he criticises for an adamant refusal to invest, the "multiplier seems to have been less than 3 and probably fairly stable in the

[26] Keynes, John M. *The General Theory of Employment, Interest, and Money*. Palgrave Macmillan, 2018, p. XVIII.
[27] Keynes, John M. *The General Theory of Employment, Interest, and Money*. Palgrave Macmillan, 2018, p. 335–36.

neighbourhood of 2.5."[28] Keynes also resonates Adam Smith's conception of government spending in support of the facilitation of "commerce in general" through roads, bridges, and infrastructural investment.[29] He recommends government investment in public works programmes to ensure that recessions are periods of long-term investment into the economy, arguing that due to the higher marginal propensity to consume, "public works even of doubtful utility may pay for themselves over and over again at a time of severe unemployment … from the diminished cost of relief expenditure."[30] Keynes further warns against doing this during times of high employment due to the risk of 'true' inflation and diminishing effects on the economy, and he advocates strongly against unfettered governmental expansion and regulation, or socialism.

Schumpeter has a moderately different view of capitalism and markets than Hayek and Keynes — for him, the ethos of capitalism is creative destruction. Echoing Spencer's view of capitalism as advancing social Darwinism — the survival of the fittest — he uses the language of the natural sciences to describe capitalism as primarily "an evolutionary process."[31] What keeps the "capitalist engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates,"[32] which entails significant improvement and therefore destructive metamorphization of the old into the new without the baggage of the old. This is the "essential fact" of capitalism.[33] While markets have, and continue to

[28] Keynes, John M. *The General Theory of Employment, Interest, and Money*. Palgrave Macmillan, 2018, p. 113.
[29] Smith, Adam. *An Inquiry into the Nature and Causes of the Wealth of Nations*. MetaLibri Digital Library, 29th May 2007, p. 560.
[30] Keynes, John M. *The General Theory of Employment, Interest, and Money*. Palgrave Macmillan, 2018, p. 113.
[31] Schumpeter, Joseph Aloïs. *Capitalism, Socialism, and Democracy*. Routledge, 2003, p. 82.
[32] Schumpeter, Joseph Aloïs. *Capitalism, Socialism, and Democracy*. Routledge, 2003, p. 83.
[33] Schumpeter, Joseph Aloïs. *Capitalism, Socialism, and Democracy*. Routledge, 2003, p. 83.

produce qualitative and quantitative improvements in the standards of living, as Schumpeter shows from an examination of the working class household's basket of consumption and its changes from 1899 through 1942, he recognises that the ethos of creative destruction also entails with it the singular problem outside the scope of capitalist fixes: unemployment. He posits that ""But in the process of creative destruction, restrictive practices may do much to steady the ship and to alleviate temporary difficulties."[34]

For Schumpeter, markets have an innate tendency to cause continuous structural transformation, in a manner that is neither slow nor measured. He notes:

> "Finally, there is certainly no point in trying to conserve obsolescent industries indefinitely; but there is point in trying to avoid their coming down with a crash and in attempting to turn a rout, which may become a center of cumulative depressive effects, into orderly retreat."[35]

The inherent volatility of markets with their desire for rapid evolution necessitates the survival of the fittest, and in this case Schumpeter positions the role of the State as a bulwark that smoothes over the failure of large businesses and industries by providing for efficient and effective transitions into newer forms of business activity. However, he disagrees with Hayek by noting that "perfect competition is the exception,"[36] and most firms behave either in monopolistic ways in their own markets or do not truly compete at all because they have no effective control over their prices of their products and inputs. This is why Hayek's goal of trust-busting is eventually ineffective, because if realised in its entirety, would result in the mandated destruction of both the entity and the market forces governed by the process of

[34] Schumpeter, Joseph Aloïs. *Capitalism, Socialism, and Democracy*. Routledge, 2003, p. 87.
[35] Schumpeter, Joseph Aloïs. *Capitalism, Socialism, and Democracy*. Routledge, 2003, p. 90.
[36] Schumpeter, Joseph Aloïs. *Capitalism, Socialism, and Democracy*. Routledge, 2003, p. 78.

creative destruction. On the other hand, like Hayek, Schumpeter believes in the essential nature of government intervention in protecting the dignity of man during periods of unemployment because failure does not discriminate; the goal of the State is articulated as "providing adequately for the unemployed without impairing the conditions of further economic development," along with the abolition of "the suffering and degradation" implicit within it.[37]

If markets do not, as a rule, self-regulate in ways that propagate freedom and liberty, and ultimately liberal democracy, the question that we face is: What, then, is the relation between regulation and markets, and the propagation of liberal democracy? This excursus of economic thought from Spencer to Schumpeter, with Hayek and Keynes thrown in for good measure, reveals a chicken-and-egg problem. Markets *must* be regulated in some way, shape, or form for them to function effectively with the aim that with the scaffolding provided by the regulation and limited government intervention will produce a desirable outcome. However, regulation also engenders more regulation, and regulation to promote self-regulation is a remarkably circular argument. But one thing is clear — governments *must* intervene, particularly in the market for labour and during times of economic recession. The slippery slide to demagoguery and then totalitarianism, as we have seen throughout the 20th century, springs forth from economic discontent and particularly mass employment. This was true even during the twilight of the 18th century, where non-noble Frenchmen rose up against the *laissez faire, laissez passer* economic policies of the physiocrats that was apocryphally articulated by Marie Antoinette as 'Let them eat cake!', caused the extreme violence of The Terror. Hayek perceptively recognises our status as *Homo*

[37] Schumpeter, Joseph Aloïs. *Capitalism, Socialism, and Democracy*. Routledge, 2003, p. 70.

Economicus, arguing that "since under modern conditions we are for almost everything dependent on means which our fellow men provide, economic planning would involve direction of almost the whole of our life."[38] A liberal democracy that truly values freedom will strive to prevent "the destruction of human values"[39] will find itself ensuring that freedom and its resultant human values are protected, for that is a *sine qua non*. What is good for the individual business may not be good for the economy or society, and if we find ourselves equating the directive principles of state policy with those same principles that would optimise profitability, for that would result in regulation riddled with the composition-division fallacy. It seems inevitable that the "liberty of some must depend on the restraint of others,"[40] whether it is man as an economic creature or man as a civilised one. The answer to the question implicit in the above assertion is only this: How much? It is between Frost and Berlin that the answer hypostatises — "that which a man cannot give up without offending against the essence of his human nature,"[41] and consequently that minimum without which the state cannot conduce the market into its primary function as both the propagator and preserver of freedom and liberty. When Keynes remarked that "in the long run, we are all dead," he was surely onto something, for he recognised the need to intervene *now* else by the time the market decided it was time to correct itself, life would not be worth living, for we would have slipped too far down the slippery slope to effectively recover.

[38] Hayek, Friedrich. *The Reader's Digest Condensed Version of The Road to Serfdom*. The Institute of Economic Affairs, 2001, p. 55.
[39] Schumpeter, Joseph Aloïs. *Capitalism, Socialism, and Democracy*. Routledge, 2003, p. 70.
[40] Berlin, Isaiah. *The Proper Study of Mankind: An Anthology of Essays*. Edited by Henry Hardy, Chatto & Windus, 1997, p. 196.
[41] Berlin, Isaiah. *The Proper Study of Mankind: An Anthology of Essays*. Edited by Henry Hardy, Chatto & Windus, 1997, p. 198.

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