

AN OPTIMISTIC WINDOW?

Greg Lindsay talks with Jerry Jordan

Global Markets in the Information Era

On November 24 1999, The Centre for Independent Studies held its annual John Bonython Lecture. The lecturer for this occasion was Jerry Jordan, President and CEO of the Federal Reserve bank of Cleveland, USA. He delivered an optimistic and spirited lecture entitled 'Global Markets in the Information Era'. He argued that globalisation was a force for good governance because it exposed political leaders to the feedback effects of their policies. Policies of good governance such as open and competitive markets, he suggested, are most likely to attract mobile capital and thus lead to higher employment and growth in countries which adopt such policies.

After the lecture, he spoke to Greg Lindsay.

Greg Lindsay: You present a very optimistic picture in your lecture about how the pressures of globalisation are likely to force governments to engage in best practice governance whether they want to or not. Perhaps it is too optimistic. There has been increasing popularity in the US and Australia—despite the fairly good economic conditions in both countries—of ideas about the increased rootlessness of modern life. We have all heard this before—it all comes from Marx. But the twist is that now that absolute poverty is no longer a problem, the exploited masses are the white collar workers who are allegedly overworked, lacking time for their families, attacked by a barrage of modern communications devices. Increasingly, the 'stop the world, I want to get off' movement is led by professionals and academics.

Jerry Jordan: You are right that we have heard all this before. There are long waves in ideas that take time to

play out. When certain ideas predominate, they foster an environment for counter-ideas. For instance, in the late 1800s Utopian Socialism was the dominant intellectual idea. The students of the people who propagated such ideas became adult leaders in the early to middle part of the 20th century. By the 1930s and 40s, their ideas seemed to dominate. While socialism was in its heyday, the countermovement in ideas—of Mises and Hayek and later Milton Friedman—was born. Their students around the world are now middle aged and older and they are the

leaders, deciding the course of events. So no doubt today there are dissidents—Marxists, people that are interested in wealth sharing, whether they are environmentalists or whatever it is that they clothe themselves in—that are starting new intellectual movements. In the future—thirty, forty, fifty years from now—their students may be in more important positions. For the moment, the tide is still going from the ideas of Mises, Hayek, Friedman and those thinkers of the early part of this century.

GL: You cited Schumpeter in your lecture. Schumpeter is of course the originator of the theory about the unsustainability of capitalism due to the

class of intellectual proletariat which it gives rise to people who are overqualified and underemployed and feel unappreciated and unrewarded by the market economy and thus resent it. Their support will add to intellectual pressures against the market economy. Perhaps the power of ideas of a disproportionately influential class is more important than economic pressures?



Greg Lindsay is Executive Director of The Centre for Independent Studies and Editor-in-Chief of Policy.

JJ: In academic circles, the forces you mentioned have always been there, although not very visible. More importantly, the issue of our time is the politics of envy. We are in a situation where corporate executives or people who set up new 'dot com' companies are earning extraordinary compensation for their innovations while other people are plugging along with small annual wage increases. And, I think an open question—one I don't have an answer to—is whether someone can exploit the politics of envy—the unfairness of it all—to gain political power.

GL: Pursuing these ideas further, you argue that the voters are not only the citizens at the local ballot box, but also the financial asset managers in global capital markets. But of course, there is no necessary correspondence between the expressed preferences of the two groups given that public choice theory argues that people are not likely to vote in their best interests. Competition within a country for votes is an invisible vacuum cleaner rather than an invisible hand. Benefits are concentrated and costs are diffuse so people are more likely to vote as groups of special interests to pillage each other and themselves. Given that the voters within are immediately more important for reelection purposes than voters in the capital markets outside, politicians will decide accordingly. What is wrong with this pessimistic interpretation?

JJ: We have a lot of evidence available from the last few years where the perverse behaviour of politicians (and in some cases business people) in some countries—whether they are engaged in corrupt or short-sighted behaviour—is quickly exposed and they are turned from office. The dominant force right now is that those people who are generating opportunities for wealth creation are being rewarded. Those people who are pursuing old avenues of trying to share the wealth—whether in the older industrial economies of Western Europe, or the emerging market nations in Latin America, or Asia, or transition economies of Eastern Europe—are suffering. Those who are doing the best are those who create the institutional arrangements to create opportunities for people.

GL: Perhaps one outcome of globalisation is that though nation states may become less important, certain regional centres and cities may grow in importance and influence.

Examples might be Silicon Valley, Wall Street, Shanghai, and Sydney. What do you think of this prognosis and may it have wider implications in terms of political and cultural realignments? Many commentators have pointed to the increased disparities between different regions in a country. In Australia, much has been made about the city-bush divide almost as if the two groups inhabited different countries.

JJ: I don't agree that the nation state is becoming less important. I think that the importance of the nation state is shifting away from economic affairs to social and cultural affairs. It's not inconsistent to say that as we enter into a borderless world with respect to economic affairs, we have a continued proliferation of borders—more and more borders, more and more nation states, based on religious groupings, language groups, and so on. It's undoubtedly true that in the last couple of hundred years, economics has played an extremely important role in deciding where the

boundaries of nation-states are. I'm arguing that in the future this will be less important and other factors such as the affinity of people to be together in the form of a nation will come into play. I see a world where it's possible to have many, many more countries than what we have even today and yet economics will not be a part of what makes them a country.

GL: Within a state, there are problems associated with an area being affluent and another area not being well off—how do you think these should be dealt with?

JJ: The question of the disparity in economic performance is one of the challenges we face in this world. In a true capitalist economy, you expect to have free mobility of goods, labour and capital. If for their own reasons people choose to restrict the mobility of other people's migration, because of geographical preferences, then the question is whether or not there is sufficiently free mobility of capital and the goods that are produced with that capital. If so, it may no longer be necessary for people to vote with their feet. A good example is NAFTA. The former president of Mexico sold NAFTA to the US and Canada with the simple argument that in the future American and Canadian consumers will buy the goods made by Mexican workers. It simply came down to the question of where

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those Mexican workers would live. If the capital was not free to go into Mexico to create jobs for them there, then the Mexicans would go into the States. What was certain was that cheaper Mexican labour was going to be employed in producing the goods that people want. So I think that the

challenge now is to find ways to get the institutional infrastructure in place in the less developed places of the world so that capital will flow in, and create opportunities in those places and reduce the push that comes from bad policies and bad government programmes which causes people to want to flee to some place else where there are more opportunities.

GL: Do you see the emergence of a new merchant law, particularly in cyberspace? What do you think of moves to regulate it, sometimes under the banner of self-regulation? Is the Internet too self-sustaining to be stifled and destroyed by these moves, can it route around them sufficiently? Or will the evolution of the new merchant law be stunted prematurely?

JJ: In part, we are going to see the spread of Internet commerce because for the moment the technology is not there to continue adequately to control it. That does not mean you will not continue to see efforts by governments to organise themselves in a concerted way to try to control Internet commerce. What's very clear is that no one country, even a very large country like the U.S., could, on its own, put a border around Internet commerce. It's far too easy for people to provide the services across the border in Canada, Mexico, or on a barge 200 miles offshore. So the only way that any country would be effective in putting limits or taxing e-commerce would be in collusion with other governments.

GL: Is that likely?

JJ: As with all collusions, there's always the potential for the free riders. Collusive behaviour is very difficult to enforce and everyone has the incentive to agree to join the cartel, and then to defect.

GL: Everyone nowadays, including those on the Left, are talking about the booming economy of the US. There are stories about people unable to work photocopying machines, nonetheless being employed in photocopying service stores. All this seems a stark contrast to Australia. Greenspan, or alternatively the Clinton Administration, has been lauded for this achievement. Yet arguably monetary policy can only do so much. In the case of Clinton, some would argue that successes at stifling some of his initiatives are more significant than anything actually done. What do you think of all this, and do you think there is anything new or profound in what has been called the 'Third Way' in Australia and the UK, and 'New Democrat' thinking in the US?

JJ: I agree with Václav Klaus, the former Prime Minister of the Czech Republic, that the Third Way is the shortest way to the Third World. Monetary policy, in providing a stability of currency, is a necessary condition for sustaining economic prosperity; however, it's certainly not a sufficient condition by itself. There are different ways of providing a stable currency, but that alone is not going to guarantee a new economy, a new paradigm. Property rights are absolutely essential, as is a financial system that allows people to use their assets in ways that create entrepreneurship and a culture of risk taking. One of the

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differences between Anglo-Saxon economies and other places in the world is the tolerance of loss making. People elsewhere would think that capitalism means a one way street, that everyone is going to get rich and there's an opportunity for a profit. However, they deny that it also requires the opportunity to make a loss, to fail, to go bankrupt. We create a lot of jobs in North America and many of the other Anglo-Saxon economies because we allow people

at a small level to take a risk of going broke. Without that element present, we can't get the effort that it often takes to bring something totally new into being and to get rich if they're successful.

GL: You are involved with many think tanks in the US, including Cato and the Reason Foundation. Has the direct role of think tanks declined since the heydays of the Reagan and Thatcher administrations, or do they continue to exert a lot of influence especially in the US, either directly or indirectly?

JJ: I think that not only has the role of think tanks not declined, but their role has increased dramatically on an even larger scale than before. Twenty years ago, it was possible that these think tanks had mostly a national or regional influence. Today they are truly global in that wherever think tanks are located, even in Sydney, Australia, they have influence well beyond their own country.

GL: One of your colleagues at Reason, Virginia Postrel, draws the new political boundaries in terms of opposition between dynamism and stasis. Do you find this distinction a useful one? Do you see these distinctions becoming more important over time? Is there, for instance, a growing convergence between dynamists in both parties, because at times it seems as if there is only stasis on all sides.

JJ: It's a very clever way of packaging the ideas of those people we used to call Luddites, to call them stasis. There are people who are nostalgic for an older, simpler and more controllable way of life, and the uncontrollability of commerce in the information age is threatening to a lot of people. The threat of something they cannot control is a central part of Postrel's argument.

GL: You argue in your lecture that people must grow accustomed to increased volatility and economic adjustment. This, of course, gels with the dynamist viewpoint shared by many classical liberal intellectuals. But to what extent is it a realistic one? Are there really only a small minority who are capable of being psychologically adjusted to these conditions of creative destruction?

JJ: People don't have to understand intellectually the forces they are responding to, as Adam Smith taught us long ago. I see the forces at work as described by the public choice literature as well—politicians are simply responding to incentives they are confronted with internal to their country, and increasingly external as well from the capital markets. They're trying to survive politically. They're not trying to promote a new world, but it may be that public choice would say that, given the new alignment of incentives, it will lead to a better world even though they may not think that is what they're doing in intellectual terms.

GL: Who has most influenced your thinking? What was the predominant economic school of thought at UCLA where you did your PhD? How much do you know about Austrian economics and how much promise does it hold compared with other schools?

JJ: The most significant influence was Armen Alchian, and then later Milton Friedman when he visited UCLA. A lot of what I was exposed to was Austrian economics. I simply didn't know it was that—but what they were teaching us were things they had learned from Mises and Hayek and others of that school. My direct influence from the Austrians and reading them didn't start until the 1970s. I think that what is called Austrian economics is on the verge of becoming mainstream. There really is no significant competition as a stream of thought to what Mises called the catallactics of human action. The expression 'human action as opposed to human design' originally came from the Scottish philosophers that predated Adam Smith although this fact seems to get lost in the literature. Mises' use of the term was unnoticed until the last 10 to 15 years, and now it's very prominent.

GL: Towards the end of your lecture, you alluded to how the best governance that the State can provide is to nurture an economic garden, rather than to be an architect or engineer. That analogy is very Hayekian and has much to recommend it, especially since it brings out the distinction between policies which promote no particular end (but really only facilitates market processes), from policies which libertals often oppose. But like all distinctions, it too has problems and some have argued that this Hayekian formulation is itself just as open ended and as capable of a wide variety of interpretations of the desirable limits of State action as the neoclassical Pigouvian one. Can you further elaborate on your formulation? How would it tackle something like antitrust which arguably can also be interpreted as a policy to protect the market process, rather than aiming at a state of perfect competition? Related to this, what do you think of the Microsoft prosecution? There are some who have gone so far as to suggest that Microsoft's dominance amounts to ownership of an essential facility in cyberspace, and that therefore it should be regulated like a natural monopoly.

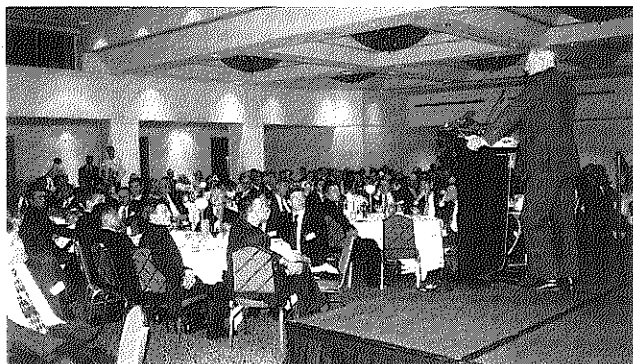


JJ: The basic element of the Hayekian infrastructure of a market economy is easy to describe—it is those things down on the sub-basement, providing a foundation on which the structure rests. But it's easy to forget that they're down there. And when someone else asks about the soundness of the structure, they fail to emphasise those things that are out of sight. In most economies that are truly market economies, this comes down to well-known, open, very clear accounting rules, auditing procedures, legal institutions which enforce property rights, sanctity of contracts, and interestingly, the idea of oral contracts. The notion that 'my word is my bond,' which gives rise to commodity markets and securities markets in Anglo-Saxon economies, truly is unique. There are elements of what I consider to be economic maxims central to a market economy, and that includes a propensity to tell the truth. These things are taken for granted. When you see the breakdowns and failures that get labelled crises in Latin America and sometimes in the emerging transition economies of Eastern Europe—when we probe very deeply—we find there was a lot of fraud, ineffective adherence to accounting standards, and a large degree of politically connected business decisions.

Anytime you allow people in a position of influence, especially commerce, to use government to favour themselves, you're distorting the market system. Again, there's nothing new about this. Adam Smith warned us about people of commerce who profess to do things for the common good.

With respect to Microsoft, I simply don't know whether they were in a position to influence existing regulations or any other form of political involvement in order to enhance their position and gain protection from other entrepreneurs and competitive forces. It can easily turn out that the recent judgement with respect to Microsoft will be as fatally flawed as were the applications of the Sherman antitrust laws in the early part of the century.

GL: You argued in your lecture that institutional arrangements coming under increasing scrutiny include



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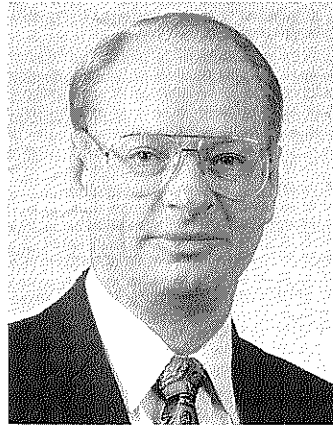
central banks and national currencies. National currencies already compete in the global market. What implications do you think the emergence of private currencies—which the Internet has given impetus to—holds for the future of national currencies? Do you think that national currencies will continue to be important, or will the use of private currencies lead to the de facto privatisation of the money supply? If the latter, what implications does this have for macroeconomic fluctuations? There are, for example, some economists like Steven Horwitz and Leland Yeager who argue that boom-bust cycles in the past were caused by what was de facto central planning of the money supply via monopoly government money failing to equilibrate demand and supply of money as efficiently as what would have emerged under wholly private, competing monies.

JJ: Increasingly, I think we are going to see private forms of monetary standards compete alongside standards of value of government. I believe we will see fewer and fewer national currencies as many places around the world choose to adopt a currency board with a rigid adherence to another currency, in which case their own currency is simply a different name for the currency to which they have pegged. Initially, I think that we shall start to see some private form of means of exchange that will be a different name for the national currency. If they are well managed and tend to be superior in reducing information and transaction costs, then over the course of decades I can foresee the potential for private means of payment to become decoupled from the national currencies they were initially pegged to—much like the US dollar was decoupled from gold earlier this century. But I think that we're decades away from that.

GL: How far can the supplanting of public services with private-grown institutions be taken? There is the view among some classical liberals of the superiority of private

alternatives to current legal systems and the possibility that, for instance, private condominium associations can provide what used to be local public goods as club goods. Of course, taken to the extreme, this is just another form of competition between jurisdictions.

JJ: One has to think in terms of the reasons that people form governments. Being an American, I take to heart the words of Jefferson and Madison that we have certain inalienable rights and that we engage in an activity called, 'the constitution of government' in order to protect these kinds of rights, and this is essential for civil society. In a much longer historical context is the analogy used by Mancur Olson of governments, in effect, being stationary bandits. Hired gunslingers that we call governments are necessary to protect us from the roving bandits. At least in the more advanced, industrialised countries of the world, I think that era has become a thing of the past. We have moved into an era of obsolescence of major wars among democracies and market economies. It borders on the silly to think of any of the most advanced countries in the Western and democratic world going to war against each other. If that is true, the main reason that we form governments is no longer to provide protection from external threats, and the only question is how much we should compensate stationary bandits to protect us in our own neighbourhoods. That's where I see the affinity factor that we're seeing at work among different peoples around the world comes into play. People want to be part of a community, among a group of people like themselves—who speak the same language, maybe have the same religions or value systems. This will result in much smaller nation states, but they have very little role in economic affairs.



GL: In Australia today there has been much hysteria over the emergence of boat people on our shores from as far away as Afghanistan. Many of these people are willing to pay up to \$100,000 a head to flee from their countries. They obviously must have the skills and personal qualities which would allow them to thrive in a modern economy to be able and willing to go to all this trouble. And, as you argued in your lecture, people voting with their feet is as important a feedback mechanism on bad governments as capital market disciplines. Yet the freedom to emigrate in the 20th century has been increasingly restricted by immigration barriers at the other end. And popular sentiments in most countries continue to place importance on the idea of enforcing national boundaries. Then there are arguably more legitimate concerns that—given the continued prominence of welfare states in all countries—more liberal immigration policies will lead to a drain on revenues, and thus constitute an infringement of quasi property rights on the present inhabitants of nation states. How do you think these issues can be resolved?

JJ: It is unavoidably true that the greater degree to which a political grouping depends on a wealth sharing set of arrangements, the greater the degree they are going to attract people from other provinces, cities, states or countries, and then they're going to want to limit access to these arrangements through immigration restrictions. One reason for advocating more relaxed immigration policies—more openness to people who want to move to wherever there are opportunities—is that it is impossible to sustain a wealth redistribution welfare state with open immigration. So, if one wants to get rid of the welfare state, one ought to be promoting an open immigration policy.

Policy

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