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Brokers, Bureaucrats, and the Emergence of Financial Markets

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Abstract

This article provides a critical analysis of Frye (2000) and existing theories of self-governance. Following up on the recent studies by Stringham (2002, 2003), we focus our attention on the emergence of financial markets for several reasons. The common perception is that complicated financial instruments require state sanction to emerge. It is widely argued that in the absence of state regulation of financial markets, cheating will be common. We maintain, in contrast, that the evidence does not support this pessimistic view. In fact, markets are capable of endogenously generating the rules that govern their operation and these rules discipline cheating severely. Finally, if we can persuasively make the case that self-governance in financial markets is effective - with the complicated nature of transactions that take place - then the argument for self-governance is economic life, we contend, is much stronger than even classical liberalism has led us to believe.

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