An Historical Note on Regulatory Reform

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ALTHOUGH by most measures the growth of government regulation in this country has continued unabated since the founding of the Republic, we are now in the throes of a deregulation—or regulatory reform—movement of unprecedented proportions. At such a time it may be useful to look elsewhere for historical precedents. One earlier massive deregulation took place in England about the time of our own Revolution—or, at least, that is the time it received its imprimatur in Adam Smith's *Inquiry into the Nature and Causes of the Wealth of Nations.* Although that reform took many decades, in the end a pervasive system of monopoly franchises granted by the King (then by the King-in-Parliament and later, occasionally, by the Parliament) was replaced by a system of more or less free and open competition.

What caused this change to occur, and can we draw any lessons from that experience for today's movement toward reform? Like those of any major political or social upheaval, the causes of the British deregulation are many and varied, not to mention complex. Thus, my analysis here is not meant to imply that these were the only forces at work. But while the interpretation is somewhat novel, it appears to have relevance for the current debate.

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Mercantilism as Regulation

In the history of economics the mercantilist era extends roughly from 1500, when colonies were being established by the European powers, to 1776, when one European power—the one we are interested in here—was losing thirteen of its colonies and when Adam Smith published *The Wealth of Nations.* The mercantilists stressed the need for positive trade balances in order for a country to accumulate gold and silver and become more powerful. Later writers—David Hume and Adam Smith in particular—showed that the mercantilist policy was inherently self-defeating because the strength of a nation depends on its capacity to *produce* (not *accumulate*) gold and silver.

In essence, however, the most significant characteristic of mercantilism was not specie accumulation but economic regulation. This is clearly true even of the trade sector, where the mercantilists sought to foster a positive trade balance through active state intervention in import and export industries. But economic regulation under mercantilism was not restricted to trade: it pervaded the whole economy.

It has never been hard to understand how economic regulation, such as that practiced by the mercantilists, arises. Economic agents of any kind seem universally to favor free enterprise in all spheres of activity except their own. That some groups will be successful in using the state for limiting entry into their industry or in receiving outright cash grants from the state was no great mystery to Adam Smith, and it is no great mystery now. Economic regulation and state interference in the economy seem to be the normal state of societies, whether those of the mercantilist period or those of the present day. The real point of interest about the mercantilism attacked by Adam Smith is that it disappeared in the years after 1776 and did not return until the advent of World War I. (Mercantilism had changed before 1776—especially in England—but though it was weaker

in 1688 than it had been in the 1620s, it was still healthy enough in 1776.) The period after 1776 shows a quasi-permanent deregulation of a national economy.

Reasons for the Decline of Mercantilism

Groups in the economy are always tempted to use, or try to use, the power of the state to increase their net worth. Such situations usually result in gains to the few at the expense of the many, with the losses to the many exceeding the gains to the few. The use of monarchical powers in England to create monopolies (whether by King or King-in-Parliament) is a case in point. Despite the net costs, such policies may be followed because the interests of the many are small (taken separately) and diffuse—so diffuse that no one may be aware of them—while the interests of the potential monopolists are large and concentrated.

The modern incarnation of this line of reasoning is called the "capture" theory of regulation. Industries seek to use the state to shelter them from competition. With state sanctions, prices rise above costs and the regulated firms earn excess profits. The prospect of securing these excess profits in turn leads to competition by special interests to secure them. Such competition dissipates some of the excess returns available under regulation, and thus efforts by special interests to secure "a piece of the action," along with the commonly cited welfare losses from having prices exceed costs, constitute the regulatory burden on society. The mercantilist era in England (1500?–1776) provided an almost perfect setting for this kind of regulation to come about. There was an active market in monopoly rights, fueled by the monarch's interest in revenues for the state treasury on the one hand (it being a time when tax collection was difficult or impossible) and the interest of those seeking monopoly franchises on the other. So why, if the conditions for state interference in the economy were so favorable, did mercantilism recede in favor of economic freedom?

Since this is not an often-asked question, it is not hard to arrive at wrong answers. Credit for the decline of mercantilism is usually given to thinkers, such as Adam Smith, who advocated the advantages of free and spontaneous coordination in the economic order. They are seen to have made such a strong intellectual case for their point of view that it was translated into public policy over a period of some years. This is obviously partially true, but while it is satisfying to believe that thinkers influence legislation, it is not clear how ideas (for all that they do have consequences) would come to undermine the powerful economic forces at work to sustain economic regulation. The alternative explanation offered here is that economic freedom came to England as an unintended by-product of a constitutional struggle over who would control the rules under which the economy prospered (or failed to prosper). In this struggle several important institutional changes took place which reduced the payoff to those seeking regulatory protection.

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The first half of the mercantilist era in England produced, or at least was characterized by, a struggle between the monarch and the Parliament over who would legislate. With occasional gaps, monarchical control over rulemaking and regulation was a prominent feature of English government until the time that Charles I was executed for treason against himself (or rather, against the King-in-Parliament) in 1649. There were two reactions to this monarchical control. First, Parliament, especially in the reign of Charles I but generally under his two predecessors as well, attempted to wrest the ability to create monopolies away from the King (or Queen). The restiveness of Parliament in this respect became more pronounced as the mercantile period wore on. Second, the merchant class grew wary of the net benefits of a regulatory alliance with the King. Specifically, uncertainty over the potential benefits of royal regulation increasingly drove merchants to support the interests of Parliament, thereby reducing the power of the monarch in economic as well as legal and religious matters.

What was merely voiced opposition to the Crown's attempts to monopolize during the

reign of Elizabeth I (1558–1603) became shouts of protest during the next forty years (though it is true the protest covered other things besides monopolies), culminating in the English Civil War. As a general rule, it may be said that after 1603—in spite of ever more vigorous attempts by James I and Charles I—no acts establishing national monopolies were enforceable if they interfered with the profits of merchants and the interests of those represented by the House of Commons and the courts (not counting, of course, the Court of Star Chamber and its kind).

Here we find the de facto end of *monarchical* mercantilism (as measured by the ability to grant monopolies) when, in the context of expanding industries, the net benefit from no regulation outweighed the net benefit from Crown protection. Note that the payoff to those seeking regulation was reduced not because a new economic doctrine was promulgated, but because of rising franchise costs (taxes), together with the vicissitudes and uncertainties of the Crown's ability to provide the promised protection (because the King, without parliamentary support, could not make the world safe for monopolists).

Both James I and Charles I tried to revive Elizabeth's early policy of patent grants as sources of revenue, but both met with very limited success (except in the cases of alum and soap manufacture). Meanwhile, the members of the Commons marshalled all of their strength to fight the King's prerogative of extracting taxes by granting franchises. After a long struggle with James over the issue, Commons revived impeachment as a means of punishing monopolists in their midst and as a means of reminding the King that they did not recognize his prerogative to establish franchises. The objection of the Commons to the Crown's supposed right to regulate the economy reached its zenith in 1624 when the act concerning monopolies legally stripped the King of all prerogatives in patents and other means of monopolizing industry.

Charles I came to the throne in 1625 and promptly set about attempting to restore the Crown's rights to grant monopolies by letters patent or by order of Privy Council (not through Parliament). In doing so, he was led to a toe-to-toe confrontation with constitutionalists (roughly, those who acknowledged the power of the King-in-Parliament, not of the King alone)—a battle that he ultimately lost, along with his head, in 1649. Meantime, Charles found a loophole in the 1624 statute—it did not apply to corporations for benefit of trade or to companies of merchants—so that after the repeated refusal of Parliament to fund the King's military adventures and after he had dissolved Parliament in 1629, Charles tried to make deals with large producers in many industries. Alum and soap monopolies had been exempted from the 1624 act, but the King encouraged the formation of huge corporations in coal, salt, brickmaking, and others to which monopoly protection was given (for fourteen years) in return for moneys paid to the Crown. (Between 1629 and 1640 the alum patent brought in £126,000, and between 1630 and 1640 the soap patent generated £122,000.)

It was the cartel breakdown and the more fundamental problems of enforcement (brought on by the stringent objections of consumers and merchants left out) that combined to make the other patents of Charles I ineffective three years after they had been issued. It turned out, in effect, that monopolists needed not only the King's support, but the support of the interests that would have been in Parliament, opposing the King, if there had been a Parliament for them to be in. Anti-monopoly interests opposed to the King joined forces with those who, on legal and religious grounds, objected to his assertion of supreme rights, first to limit and then to put an end to his authority. In a signal reassertion of rights, Parliament established its power once and (presumably) for all. Among its actions was the passage of a 1640 statute putting an end to all but one of the exceptions in the statute of 1624.

Thus, monarchical mercantilism ended when the ability of the King to control regulation was wrested away by Parliament. More important, the monarch lost this ability in large part because those who might have benefited from regulatory protection found the effects uncertain (and in many cases negative), given the benefits of an existing (or possible) competitive system.

With the end of the monarchical provision of monopoly rights—a result surely brought about by Parliament's struggle with the King—why did Parliament find it difficult to continue to provide protection for producers? The

answer is complicated and cuts across a number of aspects of legislative government in England during these times. A short summary would stress two points. First, the creation of monopolies had in some sense passed overseas —indeed, the mercantile system had produced a colonial system, to be lost with the colonies. Second, as noted, the rise of parliamentary power at home had raised the costs of procuring and sustaining protective legislation. (Eventually the rise of representative institutions overseas had an even greater cost.) With multiple decision makers (which was the case, say, in 1714 in a much more aggravated way than it is now), a Parliament will generate even greater uncertainty about the ability of regulation to protect producers than a unified monarchy—perhaps even greater uncertainty than a monarchy in which the King is going one way and the Parliament another. The rational producer will, of course, be less inclined to secure a monopoly right when the result is more uncertain.

To summarize, the declining power of the Crown and the rise of a hydra-headed parliamentary power had a twofold effect on the English mercantile economy. First, the net benefits expected by potential monopolists fell, because the chances of winning monopoly protection had become more uncertain and the costs of putting together a coalition of supporters had increased. Second, the costs to the authorities that granted monopoly rights rose, since grants could not be made unilaterally, as in the case of the King, but were now subject to a collective decision process.

More work needs to be done on the period after 1660, but it might generally be said that mercantilism at home was receding in England —partly perhaps because no monarch wanted to go the way of Charles I, partly because there was a great deal of uncertainty from time to time as to who would be King (or Queen), partly because parliamentary governments tend to change hands more often than the throne changes hands (which increases uncertainty and would have tended to have required approval of a major regulatory step by both government and opposition), partly because of the existence of colonies. Thus the attempt by merchants and Parliament to wrest power to confer monopoly—and other powers—from the monarch (culminating in the mid-seventeenth century) led to a long-run situation (lasting until the latter part of the nineteenth century) that severely inhibited the possible formation of economic regulation. The views of Adam Smith thus provided philosophical sustenance for a change that had begun more than a century before. That it was this sustenance that nourished the great flowering of competition in the century following is not to be doubted (not here, anyway), but the roots are in the struggle of King and Commons, and the lesson, in part, is that uncertainty is the enemy of regulation and especially of regulated monopoly. (Why the period of deregulation eventually ended will not be discussed here.)

Concluding Remarks

What lessons can we draw from this historical episode? Primarily, it would seem, that institutions and institutional change will have a significant influence on the degree of economic regulation—and deregulation—experienced by an economy. For example, rather than decrease the number of members of collegiate regulatory bodies (as is the present trend), why not increase the number in order to diffuse the power of individual members, and why not increase the number of collegiate bodies overseeing each industry in order to make it more difficult for special interests to have their way? As for the Congress, why not likewise increase the number of committees overseeing each industry in order to make special privileges more difficult to obtain? Better still, why not choose the members of regulatory commissions by lot and for uncertain terms—or choose the members of congressional committees the same way—so as to increase uncertainty. While such institutional changes could increase administrative costs, the net payoff to society might be considerable —if history is any guide. ■

Selected References

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