RETHINKING MARKETS[1]

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The opening lines of Kenneth Arrow's most famous book allege that:

> In a capitalist democracy there are essentially two methods by which social choices can be made: voting, typically used to make "political" decisions, and the market mechanism, typically used to make "economic" decisions... The methods of voting and the market...are methods of amalgamating the tastes of many individuals in the making of social choices [1963, pp. 1-2].

Arrow's taxonomy of how choices are made in a "capitalist democracy" represents a venerable tradition in economics—the market versus politics. But of course Arrow's distinction is false; the market is not a mechanism for <u>making</u> social choices. Markets, which are socially constructed means whereby the ownership of future value changes hands, simply reflect many individual choices which, once aggregated, hold social implications. But that is very different from the idea that markets are a means for making social choices. Still, it is popular to believe that markets can—and should—be relied upon to make social choices. Four contemporary illustrations of this belief come to mind.

A. The Environment

We find persistent advocacy of so-called "free-market environmentalism" as a mechanism for avoiding what is alleged to represent interference in the market. Were this to be tried, society would get only as much environmental protection—or as many environmental

assets—as current bidders were prepared to pay for. That future generations are not here to bid might seem to undermine the logic and appeal of this approach [Bromley, 1989c]. Indeed, the notion that those seeking an improved environment must buy it—pay polluters to stop, or pay land owners not to destroy nature—rests upon a value judgment that the current structure of property relations compels this particular market transaction. That the nation's highest court finds otherwise might be thought worthy of notice to those who advocate this approach.[2]

While market processes can be used instrumentally once there has been a prior articulation of socially desired environmental conditions, the market cannot be relied upon to decide how clean our air or water should be. Nor can the market reveal how much biodiversity must be preserved for future generations. The metaphor of the market—and the analytical devices at our disposal—can certainly help to inform such decisions, but not in the manner suggested by some market advocates.

B. Education

The metaphor of the market has also entered into discussions about what is wrong with America's schools. Predictably, the solution is found to lie in vouchers so that schools can be exposed to the bracing wind of competition. That will, we are told, cause school administrators—inept bureaucrats, after all—to focus on performance [Becker]. If they are alert and agile they survive; if not they suffer the inevitable fate of the inefficient firm.

Let us be clear about one thing: the vast majority of America's inferior schools are found in inner-city neighborhoods—or rural backwaters—rife with the debilitating social pathologies of high unemployment, drugs, absent fathers, single mothers, and crime. It is no accident that America's best schools are overwhelmingly in the richer suburbs. Nor is it a

mystery why students in private schools often seem to excel compared to those in public schools. After all, the ability to prescreen and exclude some "low quality inputs" (students) is not unimportant to the nature of the ultimate "output" (standardized test scores or life skills). But public schools cannot *a priori* exclude students—indeed they are often under legal injunction to preclude them from evicting even the disruptive student—and therefore the alleged superior performance of private schools depends upon the parallel existence of public schools to take those students excluded from the private sector. Market segmentation is at work in America's schools and this must be recognized when one alleges that public schools are inferior to private schools.

For public schools, the solution is said to lie in competition among themselves, but also with the private sector (hence vouchers). But of what possible benefit is competition among schools in areas where transportation is lacking or unaffordable? America's worst schools are horrid because the mobile segment of the population has already voted with its feet and left the immobile population behind to reap the scraps of what is left. When shops close for lack of business that is one thing; when elementary schools close in communities without mobility, the children suffer. Is the market really the correct metaphor to inform our thinking about education in America? We need creative thinking about education that recognizes parents, school boards, state-level administrators, local administrators, teachers, and students as both principals and agents in a nested model of action and choice. We do not need models that see schools as nothing but firms.

C. Freedom

There are those who will insist that markets guarantee freedom. Milton Friedman, often in collaboration with his wife Rose, has written extensively on this subject [Friedman, 1962; Friedman and Friedman]. The essence of freedom in markets is claimed to arise from enhanced choice—hence the emphasis on "free to choose." But of course it is specious to suppose that markets guarantee freedom. If this is all we mean by freedom—the opportunity to choose—then the very idea of freedom is so trivialized as to jeopardize its claim on our attention. Against Friedman's celebration of the freedom to choose which particular market transactions we will undertake—and which commodity in the market we will choose—the political philosopher C. B. Macpherson insists that freedom consists in not having to enter into any market transaction at all; the freedom to choose any particular transaction must also encompass the freedom <u>not to choose any transaction at all</u>. As long as individuals must sell or rent their labor power in order to live (eat), they are <u>not free to choose</u>. Perhaps a better way to put the matter is to say that we are <u>free to choose from opportunities not of our choosing</u>. This approach puts Friedman's freedom in a very different light indeed. And it exposes the logical flaw in the fanciful notion that markets guarantee freedom.

Amartya Sen reminds us that a coherent idea of markets and freedom requires recognition of the three constituents of freedom—autonomy, opportunity, and immunity. Autonomy concerns the freedom to choose. Opportunity concerns the freedom to achieve. Immunity concerns the freedom from encroachment by others. Those who believe that markets guarantee freedom stress autonomy (choice), and a limited version of immunity. The selective interest in immunity shows up in a deep aversion to encroachment by governments (in the form of "regulation"), but ambivalence about market-sanctioned encroachment. We see this in the aversion to regulations that address working conditions in private firms. Those who

celebrate markets see regulations as an encroachment on owners of firms, but they fail to see the absence of those regulations as an encroachment on workers. Somehow it is thought acceptable for owners of capital to enjoy immunity from interference by the state, but those who own labor power do not—except with great struggle—enjoy that same protection.

The third dimension of freedom, opportunity, is even more troublesome for those who claim that markets guarantee freedom. For instance, affirmative action programs are seen as an intervention in otherwise proper market processes. Yet when market outcomes hold differential prospects for members of a society—and when those outcomes are highly correlated with racial, ethnic, or gender attributes—the freedom of opportunity is sacrificed. Markets do not assure opportunity freedom and yet we often see arguments to let the market work as a tactic to justify opposition to actions that would enhance opportunity freedom.

D. Socialism and Capitalism

Finally, since late 1989, the metaphor of the market has taken on new importance. When the Berlin Wall came down in early November of that year, it was seen as a triumph for democracy and for the market. All of the countries in the former Soviet empire have now thrown off the chains of Stalinist economics and are rushing to embrace the market. Marxists and market advocates now declare, though with different levels of delight, that capitalism has won. While it is clear that Stalinism lost, the fundamental issue still to be worked out concerns the precise institutional nature of the apparent winner. What, precisely, is this market that is sweeping Eastern Europe and the former Soviet Union?[3]

With the recent celebration of the East Asian Miracle [World Bank], with the rise of multi-nation trading blocs that are forcing individual nations to subordinate their sovereignty to

the dictates of global markets, and with many formerly planned economies now embracing "free markets," it is appropriate and timely to reflect on the metaphor of the market. There are many doubts about the benefits of a thoroughgoing market economy and it is essential that we understand the source of these concerns. After all, if the beneficial dimensions of markets are exaggerated, and if their shortcomings are overlooked, over time we will see the nature and scope of markets as major allocative devices coming under attack.[4] Indeed, the current social and economic chaos in Russia and other parts of Eastern Europe can be seen as a potential threat to the acceptance of a market economy there. On a less dramatic scale, the current difficulties in the European Union over full monetary integration suggest that goals and priorities at the national level—many of which speak to cultural and social norms—are not easily compromised in the name of the market.

I. On Markets

These four examples remind us about how the metaphor of the market now permeates our daily lives, and they reflect a shared understanding of one way to solve the coordination problem. We know that scarcity gives rise to conflict and mutual dependence. But it is also true that conflict and dependence give rise to the need for a constructed order. From this constructed order societies then innovate mechanisms to deal with the necessity for exchange in a world of differentially situated scarcity and abundance; the market is one of those mechanisms. The fundamental issue for any society concerns the nature of that prior constructed order out of which markets arise. There is contention on this matter precisely because some have chosen to believe selected parts of Adam Smith to the effect that order arises spontaneously from market processes (the "spontaneous order" of Hayek). Others,

starting with Karl Polanyi, insist that the market is an <u>instituted process</u> [Polanyi]. The metaphor of the market is usually seen by economists in Smithian terms rather than in Polanyian terms.

This accounts for the perception that markets are natural process that will automatically emerge—and that are largely self-regulating—if only governments will get out of the way. This is the <u>laissez faire</u> proposition. There is the companion proposition that the outcomes of markets are presumptively beneficial in a social sense. This presumption then leads to the epistemological supposition that the market provides a clear and coherent norm by which to judge the propriety of particular allocative outcomes.

These presumptions about the market lead me to focus my comments on three related aspects of markets and market processes. The first aspect concerns the process of creating markets where none existed before; here the issue is one of the nature, speed, and scope of the <u>marketization</u> of formerly planned economies. The second aspect concerns the problem of socially unacceptable outcomes from market processes. Here I address the presumptive propriety of markets and then the subsequent use of market criteria (and outcomes) to guide and inform an evaluation of new public policies to correct the anti-social results. My third topic concerns the conflict that arises among nations when imperatives of the new global market threaten perceptions of national autonomy and sovereignty; here the issue is the dubious coherence of the idea of comparative advantage of such importance to notions of "free" trade.

In essence, I shall be exploring the construction of a market economy, the necessary modifications and adjustments in a market economy, and the frequent tensions between two or

more market economies when the seeming imperatives of free trade conflict with notions of national sovereignty.

A. Constructing a Market Economy

The economic free-fall in Russia and parts of Eastern Europe over the past seven years serves as a stark reminder that well-functioning markets must be carefully constructed by, and in the presence of, a coherent nation state. The common idea that markets will arise and work well if only governments would get out of the way has been shown to be erroneous. Indeed, the scale of human misery in Russia (and neighboring countries) from this notion reminds us that markets only work well (with low transaction costs) if they are carefully constructed—and continually reconstructed—by a coherent state [L. Friedman; Horwitz; Hurst].[5]

I suggest that an economic system must be thought of as a set of ordered relations that define realms of individual autonomy. The essential problem of economic organization is to design a set of signaling devices (exchange opportunities)—and thus signals (relative prices)—that will guide self-interested agents to act in the interest of the larger community. Markets are signaling mechanisms, but markets cannot function in a world without institutional structures of one form or another. Markets, if they are to represent legitimate signaling, must function so as to hold down three kinds of transaction costs: (1) the costs of obtaining information about possible exchange opportunities; (2) the costs of negotiating contracts or bargains among market participants; and (3) the costs of enforcing bargains or contracts that have been struck.

This focus on the necessary institutional arrangements underlying a viable market economy reminds us that shared values and norms of a particular society are the necessary

precursors of such institutional arrangements. Whose interests are to count? How will these interests be articulated through the legal and political system?[6] Who should own a nation's natural and created capital?

A civil society requires the existence of an authority system to recognize and enforce property rights and contracts. The authority system will be manifest in terms of the social norms and legal relations it defines and enforces. We may regard the necessary characteristics of a meaningful social and legal system to be: (1) clear lines of authority and the division of responsibility among governmental units; (2) clarity and precision in norms, conventions, and legal rules; (3) mechanisms and processes for the protection of property rights; (4) procedures that offer stability and predictability in economic transactions; and (5) a sense of fairness focused on the law as a transparent and accessible process [Bromley, 1993].

The central problem for any nation-state (or household or village) is to create institutional arrangements that will channel self-interest into socially useful directions. This requires more than having government get out of the way. It requires an explicit role for government as agents of the political entity we know as the nation-state. In the absence of that, one has a brand of low-level anarchy in which aggressive individuals can become very rich by selling what they most probably do not own. The contrasts between the recent economic chaos of Russia and parts of Eastern Europe, and the unprecedented economic growth in China, should be instructive in this regard [Burawoy].

The state must establish an institutional structure that will encourage initiative on the part of individual economic agents, and it must create the means and opportunities for that institutional structure to be modified through time as social and economic conditions warrant. A viable economy is determined by the extent to which institutional arrangements can be

fashioned to preclude the persistence of socially unacceptable outcomes. Entitlements—rights and duties—cannot exist in the absence of an enforcement structure to which individuals can turn to have their claims given protection. The nation-state is an authority system whose purpose is to give legitimacy to all transactions. For instance, the state is the sole entity to print and control the currency. Similarly, the state is the final arbiter of rights and duties among individuals within its jurisdiction. When one has rights it means that the state can be compelled to come to one's defense in a dispute with others. To have clear contractual rights in exchange means that the state stands ready to enforce agreements surrounding that exchange. In this way the state is a party to every transaction. The compelling question then becomes, how shall the state act in its capacity to influence the nature and content of market transactions?

Institutions (the working rules) allow us to carry on our daily lives with a minimum of repetitive and costly negotiation. Institutions reduce transaction costs, and they indicate what:

> ...individuals must or must not do (a duty), what they may do without interference from other individuals (privilege), what they can do with the aid of collective power (right), and what they cannot expect the collective power to do in their behalf (incapacity or exposure). [Commons, p. 6].

It is the prior establishment of these institutions that underpin market processes. Indeed, markets can only exist within a social and legal system that has consciously set out to create ordered domains of exchange. Note that the idea of ordered domains does not mean rigidity.

No economic system can thrive if encrusted in an inflexible institutional structure that does not recognize the exigencies of new technology, new scarcities, or new preferences on the part of buyers. Indeed, this flexibility—and the compelling incentives that markets provide—represent one of the main benefits of market processes as opposed to command processes. At the same time, the flexibility of a market economy must be attributed to the legal arrangements that can change in response to new circumstances, not to the mere existence of markets. Markets do not cause adaptation to new conditions. Rather, markets allow responses to those situations as permitted by the legal foundations of the economy.

Markets can be regarded as "efficient" only when the legal foundations exist to hold down the costs of transacting across time and space; stock exchanges personify this condition. Markets are also compelling allocative devices only when they are so structured as to prevent the exercise of economic power. The lessons of American economic growth are dominated by the instrumental use of the law to discourage economic concentration, and to encourage enterprise [Horwitz; Hurst; Marion]. The economic lesson to be learned from the economic transformations in Russia and other parts of the former Soviet Union (and indeed in China) is clear: markets do not materialize from a situation in which governmental action is absent; markets only flourish—and emit socially pertinent signals (prices)—with the conscious crafting of laws that force competition, and that hold transaction costs low. The corollary is, of course, that societies create and allow those exchange opportunities that appear to offer acceptable outcomes. When those outcomes fail to match expectations, the processes that underlie those outcomes will be modified accordingly. And this brings us to the contentious matter of public policy as it pertains to markets and market processes.

B. Necessary Modifications in a Market Economy

Turning from the creation of a market economy to its maintenance, we move from the problem of creating realms of transactional and possessional security to the problem of creating necessary flexibility in the working rules—the institutional setup. This brings us to the domain of policy analysis and consideration of the benefits and costs of economic change. Here we usually encounter a market test of a proposed change that asks whether such change is in the interest of efficiency or is it merely redistributive? The market becomes, in this approach, a referent for our analysis of public policy, and an organizing framework for helping us to think about economic change [Arrow, et al.]. Because economists tend to regard the individual as the sufficient unit of analysis,[7] it follows that the choices made by individuals carry some considerable significance. And when agents come together in the market, we regard this process as revealing something fundamental about human nature, about choice, and about relative value [Shackle]. To economists, the outcomes from bargaining transactions in markets are thought preferable to political outcomes.

The belief that market processes are preferred alternatives to politics is certainly not to be blamed on Arrow. But his dichotomy reinforces, in the minds of many economists, the notion that markets can do what politics cannot. Arrow's dichotomy provided axiomatic reinforcement to the idea that since voting could not be relied upon to generate consistent social choices, the obvious alternative—the market—stood ready to do what voting could not. And so we tend to see politics as concerned with the creation (construction) of choice domains (opportunity sets), while economics is concerned with choice from within those opportunity sets. The two are merged in the "public choice" paradigm so that politics is modeled as but another market.

The question I seek to explore here concerns how economics came to a state in which the metaphor of the market provides the durable norm (truth rule) by which we regard most human interaction—whether in elementary education, in formulating environmental policy, or in spinning wistful yet specious stories about personal freedom? How did the metaphor of the market come to represent both the universal means for judging good resource allocation, and also the shield behind which economists hide so as to be thought objective?

The answer to these related questions can be found in the profound impact of Lionel Robbins and his logical positivism. Robbins single-handedly redefined the subject matter of economics, and he offered an epistemological manifesto that has dominated economics since the late 1930s. The positivist part of the Robbins agenda was soon distorted by Milton Friedman to form the methodological core of his Essays in Positive Economics [1953], a book of sweeping and unfortunate influence on what most economists understand about economic epistemology.[8] However, both Robbins and Friedman failed to offer a logical understanding of the idea of objectivity because they did not recognize that the notion of objectivity is meaningless unless one acknowledges the normative base on which the concept of objectivity rests. One can only be objective with reference to some prior standard. That standard, not revealed by *a priori* reason, must be chosen by the scientist; that is the normative base.[9]

Robbins—exhilarated by the dogma of the Vienna Circle—was in thrall of logical positivism and proceeded to offer economists a clear choice; either accept his notion of economics or stop calling yourself an economist. We need to recall that during the latter half of the 19th century, and in the early years of this century, economics was concerned with understanding and explaining the causes of national and individual income and wealth [Cooter and Rappoport]. Robbins dismissed this epistemological program as merely classificatory. To

the committed logical positivist there are only two types of propositions allowed in science—formal propositions and factual propositions. The first are tautologies, while the second require correspondence with sensory data from the real world. The positivists believed that other kinds of propositions represented the infusion of values and metaphysics into science. Robbins issued his manifesto in 1932 in that famous tract An Essay On the Nature and Significance of Economic Science [1932].

Here was sermonizing of the first rank. Robbins devoted his book to high condemnation of Marshall and Pigou, but especially of his London colleague Edwin Cannan.[10] Economics, we were told, could never be a science as long as it was merely classificatory. Robbins knew what economics needed to be thought scientific; it needed a demarcation rule that would accomplish two things: (1) tell economists what they should study; and (2) tell them how they should study it.[11] It is from Robbins's pretensions that contemporary economics received its epistemological program: "Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses [Robbins, p. 16]." Unfortunately, this sharp distinction between ends and means is logically untenable.

However, this view took root and flourished with the eventual ordinalist triumph that reduced most human action to price theory writ large. And so today economics stands as one of the very few disciplines to be defined not by its subject matter (the economy), but by its epistemology (scarcity-driven rational choice). Much of economics these days is less about the economy than it is about economizing behavior. The micro-foundations of macroeconomics brought this view to the realm of aggregate economic forces, and then the idea of rational expectations introduced perfectly omniscient agents forever one step ahead of public policy.

The circle was complete—economic agents could perfectly anticipate all collective action and hence render it unnecessary, if not counterproductive.

Indeed, the centrality of markets is so pronounced in economics that instances in which markets do not (or cannot) work are regarded as cases of market failure—with the immediate implication that we should see what is necessary for markets to be established. Or, we derive the outcome that would obtain if a market could but be established [Vatn and Bromley, 1997]. Despite the usual abhorrence of value judgments by economists, notice that this advocacy of markets is a value judgment about how resource allocation decisions ought to be made in society.[12] That this value judgment is shared by most economists does not render it less value-laden; it simply embeds the wonder of markets in the belief system into which young aspiring economists are socialized.

The Robbins declamation about objectivity and science played a critical role in the early discussion of policy analysis. The research program laid down by Robbins did not permit economists to say anything at all about public policy since those declarations would require the introduction of something unobservable—interpersonal comparisons of utility. A number of economists mounted forceful renunciations of Robbins, but the objections of Harrod, Hicks, and Kaldor are particularly relevant here. All three thought that the implied research program of Robbins denied too much. Welfare economics received its initial impetus from these debates, with the potential Pareto test being advanced by Kaldor to satisfy Robbins's stricture against interpersonal comparisons of utility, yet to salvage a role for policy analysis under the pretense of scientific objectivity. Shortly thereafter, Abram Bergson would do much to provide the theoretical underpinnings of modern welfare economics.

Indeed, the period up until the Second World War saw the full development of optimism about welfare changes. Shortly thereafter the optimism just as quickly dissipated under the twin assaults of Graaff , and Little. Despite these early theoretical doubts, the calculation of economic surpluses from which statements will then be made about the economic wisdom of particular policies has a long tradition in economics. We know this as "welfarism." Today, economic theorists regard welfare economics with mild contempt.[13] Yet, some applied economists still apparently believe that welfare economics provides a logically coherent and empirically sound basis for collective choice. Evidence to the contrary from the most distinguished welfare theorists seems not to have been noticed by those intent on conjuring measures of gains and losses to show that particular policies are either welfare increasing or welfare decreasing. For those who remain committed to this line of work, the writings of Boadway [1976, 1978], Blackorby and Donaldson, Chipman and Moore, Gillroy, Gorman, Mishan [1969; 1980], Samuelson, and Tribe might be instructive, though hardly reassuring.[14]

The implications of this situation are profound for applied economists. While it might seem that we are left with precious little to contribute to the policy debate if we cannot calculate welfare gains and losses, I am more optimistic. I suggest that there are many other ways for the economist to be useful to the policy process. We could very well start with the gentle suggestion that policy makers may often be asking the wrong question, or perhaps posing the problem incorrectly. Indeed, a major contribution of economics to public policy is found in the questions we ask, rather than in the answers we provide. Let us dedicate ourselves to improved policy analysis through the enhanced logic and clarity that economics

can bring to the way in which social problems get defined and framed. This is a noble task indeed. And it is a recurring challenge.

Indeed, the continual need to recreate the institutional foundations of a dynamic market economy offers an important analytical opportunity to applied economists. We must figure out how to be useful to that process without allowing ourselves to be deluded by the notion that imagined welfare gains and losses say anything at all useful about which economic changes are socially preferred [Mishan, 1980]. We cannot know what is <u>socially preferred</u> and the sooner we cease the pretense that we can, the easier it will be for us to be taken seriously in the policy process.

C. Relations Among Market Economies

The spread of multi-nation trading blocs, and the full development of the World Trade Organization in Geneva, signals the final step of the vision spawned at Bretton Woods in 1944. Nations will now engage in international trade at two levels—<u>within</u> regional trading blocs (NAFTA, MERCOSUR, EFTA, EU, ASEAN), and <u>between</u> trading blocs. All of this international market activity will be watched over by the World Trade Organization in Geneva, where the guiding principle will be to avoid distortions in the terms of trade.

The obvious question for applied economists concerns the nature of distortions against which the WTO will be on guard. That is, what—precisely—constitutes a “distortion” in international markets? While the pure theory of trade (and comparative advantage) is rather clear on this point, the clarity of the theory is not matched by its empirical coherence. While few economists are against free trade, serious conceptual and empirical problems arise in

deciding what that term means in practice. We can see this difficulty most clearly in the realm of trade and environmental protection.

Many OECD countries are now struggling with the environmental implications of agriculture. It is clear that economic policies in general—and agricultural policies in particular—hold important implications for the environmental aspects of the rural countryside. One important policy challenge is to make sure that governments are not paying—via cost-sharing—for behaviors on the part of farmers that should properly be considered as normal good stewardship of environmental resources; lacking that assurance, the public purse is exposed to strategic behavior. At the same time, we know that many developed nations face the problem of excessive production. Indeed, in more than a few OECD countries, commodity abundance seems to be the norm [Bromley, 1996].

Given commodity abundance, agriculture in most developed countries can now be seen as an endeavor that provides rural landscape management, and also some marketable commodities [Bromley and Hodge]. Recognizing the joint-product nature of agricultural production is important to the debate concerning the environmental benefits and costs of agriculture. Some observers will suggest that there are normal production practices in each ecological setting that serve to determine a "natural" level of costs of production. This approach then leads to a discussion of subsidies and distortions that contravene a claimed inherent comparative advantage. Recent concern for revising world trade arrangements reinforces such thinking.

Serious conceptual and empirical problems will arise, however, if particular countries decide that they will adopt—or maintain—certain agricultural policies to keep the rural countryside populated and well managed in terms of rural amenities (as they define that idea).

On what grounds can these policies then be labeled trade distortions for agricultural commodities traded in world markets? There is a belief in some quarters that an unfettered market will reveal this idealized state of affairs, and from this one might begin serious discussions about a natural comparative advantage in trade. However, comparative advantage is simply an artifact of a large number of natural conditions and socially constructed policies (institutional arrangements). Sometimes the social construction of "comparative advantage" will be rather obvious, but not always. Simply put, the seeming clarity of trade distortions is not empirically straightforward. The task before the new WTO is formidable indeed.

In a related vein, locally defined public health considerations will often challenge the seeming conceptual clarity of open markets. Recently the WTO ruled that the European Union's ban on hormone-treated beef from the U.S. was illegal because it was not based on a "scientific justification [Andrews]." The ruling, while currently favorable to U.S. livestock interests, could eventually cut the other way by challenging existing U.S. health and environmental standards that have broad public appeal, yet fail to pass a test of sound science in an international tribunal such as the WTO.

Here we see the alleged imperatives of the market (and science) coming in conflict with national perceptions and policies concerning the safety of imported food. Or, as in the earlier example, appeal to the market seems to justify outcomes that are in conflict with the way different nations seek to maintain particular rural landscapes and provide meaningful employment opportunities for rural people. Is Japan to be punished by the WTO because it seeks to maintain its paddy agriculture as an important buffer against violent rainstorms? Are European countries to be penalized in the new world trade regime because they want to keep

rural areas well populated, aesthetically pleasing, ecologically sound, and moderately prosperous? If so then we can predict that the WTO is in for a hard time.

Indeed it seems reasonable to predict that the long-term viability of the new international trading regimes, and the central role of the WTO in eliminating alleged trade distortions, will very much depend on the extent to which the claimed imperatives of free trade are modified in recognition of the dubious nature of these so-called distortions. After all, super-national agreements are only as durable as the willingness of member states to continue to abide by them. We see, in other words, that the role of the market in weaving together a seamless world of trade and commerce is a fragile thing indeed. There is no natural law of comparative advantage among sovereign nations.[15] There is, instead, constructed economic advantage that can be—and often is— manipulated to the benefit of particular nation-states. Applied economists have a marvelous opportunity to make sure that the advocates of free trade are held accountable for the conceptual and empirical problems associated with that notion.

II. RETHINKING MARKETS

There is no such thing as <u>the</u> market. Rather, there are infinitely many ways of constructing domains of exchange—each one reflecting prior collective notions and expressions of who counts, and what is valuable and useful. Scarcity itself is a social construct since markets allow those who own currently valuable objects to withhold them until the owner's reservation price is met. That is, the legal foundations within which any particular market is embedded accord certain individuals the rights of ownership which legitimize that withholding. The lessons of the Bengal and Irish famines remind us of the social construction

of scarcity [Drèze, Sen, and Hussain]. Indeed, hunger in America—a land of no discernible shortage in food—is itself a social construct.

The essence of a market is the realization of exchange opportunities and the corresponding emission of signals about those exchanges. The failures of the centrally planned economies of the former Soviet empire illustrate the naïveté—indeed the arrogance—of central planners who disregarded the powerful incentive effects of market signals. Unfortunately, the recent celebrations (bragging, actually) about the magic of the market ("capitalism has won") run the very great risk of introducing a new form of hubris and conceit. The unseemly chauvinism displayed by the Clinton administration concerning the miracles of the American economic model at the recent G-7 meeting in Denver reminds us that this danger may already be upon us. When over 20 percent of the children in America live in poverty, one might hope for some little modesty about the wonders of the market. Sedulous attention to interest rates and the threat of inflation reflects the concerns of the owners of capital as against the owners of labor. And while official unemployment is indeed low, the streets of some inner cities—and of most Indian reservations—reveal the misleading nature of this particular statistic.

Moreover, it is now recognized that the distribution of income in America has become very much more skewed over the past 10-15 years [Gottschalk and Smeeding; Mills and Lubuele]. When, one might ask, will the Gini coefficient become an economic indicator on a par with the Federal Reserve's discount rate and the federal funds rate? We see that the market works its wonders in reference to the particular indicators a society chooses to sanctify and to monitor. This too is a social construct.[16]

Recently a few voices have been raised questioning the excessive celebration of the market as the proper recipe for the developing nations. In what he calls the "liberal creed,"

Lance Taylor criticizes the development prescription now stalking the countries in the smaller latitudes. He notes that, in contrast to the liberal creed, the most impressive growth in the developing world has come from those states where the government has been an active and constructive participant in that process. Amsden [1997] has made a similar point.[17] Indeed, the tired dichotomy between the free market and government intervention fails to capture the reality of the so-called High Performing Asian Economies (HPAEs)—especially Singapore, Japan, Korea, and Taiwan; these are not market economies as we normally understand that term. Even British Hong Kong, often held up as the paragon of *laissez faire*, has a long history of protection of its dominant manufacturing sector (textiles) [Amsden, 1994].

The market is now offered up as the preferred solution to a wide range of problems, and as the truth rule by which to judge particular policy outcomes. Unfortunately, advocacy for the market rests on a false dichotomy between the free market and so-called government intervention, it ignores the constructed scarcities around which economists mobilize our analytical equipment, it ignores the logical impossibility of the market as a coherent metric by which to judge policy change, it is confused about the role of markets as guarantors of individual freedom, and it is predicated upon the quaint idea that market-based outcomes offer economists an objective truth rule for pronouncing on the social desirability of particular allocational results. Unfortunately, the logically compelling advantages of markets and market processes run the risk of being discounted or ignored as skeptical observers tire of the exaggeration.

In one sense, economics has, since the early part of this century, been caught up in—and has been a part of—the larger geo-political struggle about whether a planned or a market economy is the superior way to organize social provisioning. While central planning

lost the battle, it is not so obvious that “the market” has won. But the demise of Stalinist economics would seem to provide us with some opportunity now to be more circumspect about the alleged wonders of the market. This means that we can relax a bit and look for creative ways to offer up a more defensible justification for the market in various realms of public life. Claiming too much, while possibly excusable during the Manichean struggles with Soviet planners, is now both unnecessary and unpleasant. It is also incoherent and therefore misleading. Having won the battle against the planners, we must now be wary of losing the war to the general citizenry at home who remain seriously conflicted and fickle about the wonders of the market. In short, it is time for some modesty about the alleged magic of the market.

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NOTES

[1] Fellows Address at the annual meeting of the American Agricultural Economics Association, Toronto, Canada, July 27-30, 1997. The author is Anderson-Bascom Professor and Chair, Department of Agricultural and Applied Economics, University of Wisconsin, Madison. I am grateful to Brad Barham, John Braden, Emery Castle, Jean-Paul Chavas, Bruce Marion, Glen Pulver, and Ford Runge for helpful comments on an earlier draft.

[2] Several important Supreme Court decisions clearly reject the idea that an improved environment must always be "bought" either *ex ante* via a "market transaction," or *ex post* via court-ordered compensation. See, especially, *Just v. Marinette County* [201 N.W. 2d 761 (Wis. 1972)]; *Keystone Bituminous Coal Ass'n v. DeBenedictus* [480 U.S. 470 (1987)]; *Miller et al. v. Schoene* [276 U.S. 272 (1928)]; *Penn Central Transportation Co. v. New York City* [438 U.S. 104 (1978)]; and *Babbitt v. Sweet Home Chapter of Communities for a Greater Oregon* [115 S.Ct. 2407 (1995)].

[3] We may recall that much of the discussion in Europe during the early 1990s concerned the feasibility of a "third way" between Stalinist *dirigisme* and markets as we are thought to have them in the West.

[4] We see this every spring when the compensation of corporate executives becomes the subject of public comment. In essence, while modest compensation (and small annual increments) are thought necessary to keep hourly workers focused and alert (and to keep U.S. firms "competitive"), those who manage large corporations cannot, apparently, be compensated enough in the constant battle to keep their mind from wandering off. The

proper remedy for the seemingly irresistible temptation of sloth is seen differently depending on whether one is a manager or a worker.

[5] I assume here that the state is legitimate (democratic) and not some imposed dictatorship.

[6] We may wish to recall that our own political history is one in which the right to vote was at one time denied to women and African Americans. Indeed, ownership of land was a necessary condition for voting in the early days of the republic.

[7] This perspective constitutes methodological individualism.

[8] Interestingly, Friedman is not a positivist at all but a methodological instrumentalist: theory is merely an instrument to allow predictions.

[9] Emery Castle was very helpful in clarifying this fundamental point.

[10] Cannan incurred the wrath of Robbins by supporting the Fabian Socialists—a threat to Robbins of evidently vast proportions.

[11] It is interesting to see Robbins, so dismissive of the economics of the day as being simply "classificatory," offer up his own classificatory scheme. Equally surprising is that Robbins failed to notice that his manifesto regarding the necessary conditions for science (consisting exclusively of either analytic or synthetic propositions) violated his own demarcation rule (since his rule fails to satisfy either of his two conditions for being a scientific proposition). So much for "science" in the service of defining the proper domain of science. This point was noticed by Fraser.

[12] Coase and Simon remind us that in fact the vast majority of allocation decisions in a modern economy are not made in markets <u>guided by</u> prices, but are made in organizations <u>compelled</u>

by command and obedience. Simon insists that ours should be called an "organizational" economy rather than a market economy.

[13] The fundamental problem arises in the mapping of economic valuations into statements about what is socially preferred [Mishan, 1980]. Recall that for every initial structure of income, working rules of the economy, and entitlements (property rights) there is a unique Pareto optimal allocation of resources (this is the first of the two fundamental theorems of welfare economics); change those initial conditions and the "optimal" allocation will change. But each of these "optimal" allocations is Pareto non-comparable with the n-1 alternatives. We are left with the problem that all comparisons of so-called "efficient allocations" are, in fact, comparisons of the initial conditions (income distribution, structure of entitlements, institutional arrangements) which together are the basis of each "efficient" allocation. This necessarily reduces welfare economics to a comparison of the initial conditions within which economizing occurs. That there is no clear "ethical consensus" for evaluating these initial conditions renders the exercise circular and futile [Bromley, 1990; Mishan, 1980].

[14] I have written on this general topic as well [Bromley 1989a, 1989b, 1990; Vatn and Bromley, 1994].

[15] Of course there are physical attributes that define, for instance, regions within which particular crops will grow. But beyond these parameters, the rest of it is a social construct.

[16] There is some limited evidence that things may be changing on this front. For discussions of the matter of income distribution see Atkinson, and Gottschalk and Smeeding.

[17] I have commented on this issue as well [Bromley, 1995]. For a particularly insightful overview of the relevance of the "East Asian Miracle" see Amsden [1994] and the related articles in that same volume of World Development.