How Mythical Markets Mislead Analysis:
An institutionalist critique of market universalism

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1. Introduction

An enduring theme in the work of **János Kornai**: the importance of understanding the mechanisms that govern the flow of information in any complex economy *…*

… taking into account *all* information signals, and not market prices alone.

This implies a meaningful analytical distinction between market and non-market allocation mechanisms.

1. Introduction

János Kornai on Western economics:

“I found two typical errors … One was the tendency to idealize the market without impressing on economists sufficiently the need for state action and other auxiliary regulatory mechanisms.”

“The other was the its failure to point to the true advantage of the real market and the forces propelling capitalism …”

“Its picture of the market was at the same time too rosy and not rosy enough.”

1. Introduction

János Kornai (2006) on the review of *The Socialist System* (1992) by Vláclav Klaus and Dušán Tříska (1994):

“They had not a good word to say about my book. … I had diverged unnecessarily from the tried methodology and conceptual framework of mainstream economics.” …

In their view: “The communist system did not show a single feature that could not be examined in the customary way, with optimization models and the arsenal of conventional micro- and macroeconomics.”

1. Introduction

János Kornai (2006) on the review by Vláclav Klaus and Dušán Tříska:

"… The role of the public sphere, in their view, could be clarified fully in terms of public choice theory, which stated with general validity that a politician displayed behavior tending to maximize his or her power or material interests." …

"University departments of political science, if they took this review to heart, would immediately dissolve and let their members retrain as neoclassical economists."

1. Introduction

Aside from the policy issue of markets versus state intervention …

… we must be able to recognize what is, and what is not, a market.

Kornai’s work has very much been about the development of conceptual tools, not only to recognize the difference, but also to understand reasons for divergences in outcomes.

1. Introduction

We must distinguish ***market universalism*** from ***market fundamentalism.***

Market fundamentalism is typically defined (mostly by its critics, such as **Soros** 1998, 2008, **Stiglitz** 2008 and **Block** and **Somers** 2014) …

… as the belief that unfettered markets bestow welfare and prosperity, and that state interference with market processes generally *decreases* human well-being.

1. Introduction

By contrast, ***market universalism*** as defined here is *not* primarily normative, but analytic.

It is ***not*** about the desirability or undesirability of markets: it does ***not*** address their ideal extent in any economy.

Instead, ***market universalism*** proposes that *markets are ubiquitous*, or nearly so, as if they were the universal essence of unhindered human interaction.

1. Introduction

Market universalism weakens ***market fundamentalism***:

if markets are already omnipresent then their promotion loses ideological potency.

Both *supporters* and *opponents* of market fundamentalism should reject market universalism.

2. The slippery notion of the market

William Stanley Jevons (1888) wrote of the *market* “to mean any body of persons who are on intimate business relations and carry on extensive transactions in any commodity.”

Hugh Gravelle and **Ray Rees** (1992): “a market exists whenever two or more individuals are prepared to enter into an exchange transaction.”

2. The slippery notion of the market

But the terms “transaction” or “exchange” also require definition.

Ludwig von Mises (1949) saw all action, even by an isolated individual, as “exchange” – as an attempt to swap inferior for superior circumstances.

Georg Simmel (1907) described production as an “exchange with nature”.

Irving Fisher (1907) wrote of producers “continually hunting ... for bargains with Nature.”

2. The slippery notion of the market

Markets can be defined narrowly or broadly.

We need **some minimal conditions of a market**.

If a socio-economic phenomenon has all the characteristics: [x_1, x_2 … x_n],

- then it is a market.

If a socio-economic phenomenon *lacks* one or more of subset characteristics [x_1, x_2 … x_m]

where $m \leq n$, and n is the number of characteristics in the whole set,

- then it is *not* a market.

2. The slippery notion of the market

A market entails a system of accepted rules, enabling multiple traders to enter into voluntary agreements …

… involving mutual obligations that are intended to lead to the agreed delivery of goods, assets or services, …

… in return for some agreed payment, with the agreed transfer of rights to the goods or assets.

3. Mythical markets

Mythical markets here refer to phenomena that are *described* as markets, but are **not** markets, at least by the minimal requirements shown previously.

3. Mythical markets

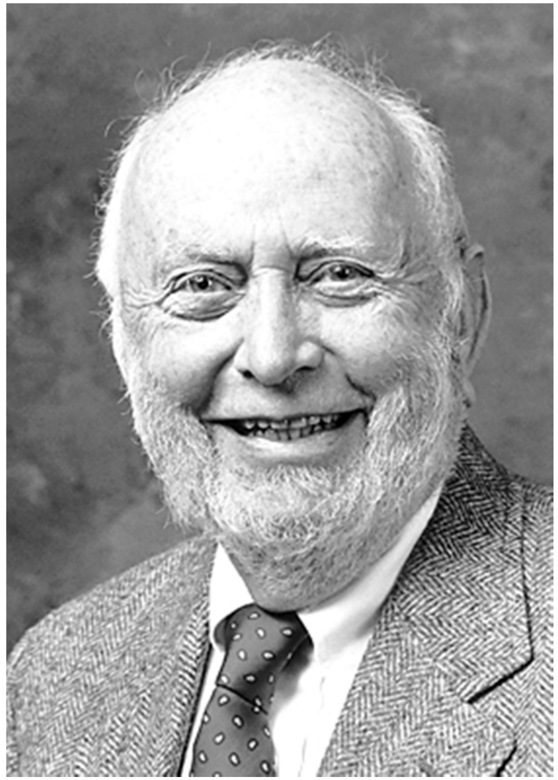
For example, **Ronald Coase** (1974) and **Coase** and **Ning Wang** (2012 – on China) described and advocated a “market for ideas”.

Coase and **Wang** did not refer to intellectual property. They referred to the need for “freedom of speech and expression” and for “the creation and transmission of knowledge” through educational institutions.

3. Mythical markets

Douglass North (1990a, 1990b) promoted an inadequately-defined concept of “political market” – applied to all democracies.

The notion of “political market” is strangely indifferent between less corrupt democracies and others (such as India) where the (illegal) buying of popular votes and the votes of elected politicians is frequent.



3. Mythical markets

More examples:

“Internal markets” within firms (**Doeringer** and **Piore** 1971)

Bruce Benson and **Eric Engen** (1988) envisioned “the legislative process as a market for laws” where interest groups “pay” legislators for laws as “products”.

- problem of infinite regress.

4. Analytical problems with market universalism

Market universalism impoverishes the concept of the market.

The logic of infinite regress invalidates the notion that everything can be traded on markets.

Émile Durkheim (1893): contracts require preconditions that cannot themselves be fully contracted: “in a contract not everything is contractual” regress.

4. Analytical problems with market universalism

The “exchange” of information has odd properties **(Nelson** 1959, **Arrow** 1962)**.**

In a market economy, not all information can be traded.

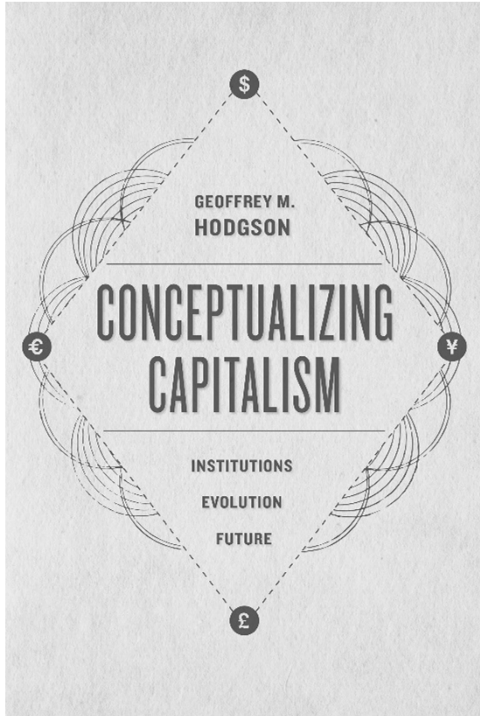
The extension and subdivision of ownership in a densely interconnected knowledge economy can create an “anti-commons” where trade is obstructed (**Heller** 2008, **Pagano** 2014).

4. Analytical problems with market universalism

In a non-slave economy, wage-workers are legally "free" to quit their jobs.

In an economy with wage-workers, *there cannot be complete futures markets for labour*.

Capitalism unavoidably entails "missing markets".



4. Analytical problems with market universalism

Consider the general equilibrium theory of **Kenneth Arrow** and **Gerard Debreu** (1954)**.**

Oliver Hart (1975) showed that in "an economy with incomplete markets … the usual … assumptions are not sufficient to ensure the existence of equilibrium" and a market equilibrium may be Pareto suboptimal.

Furthermore, "if we start off in a situation where markets are incomplete, opening new markets may make things worse rather than better. In this respect, an economy with incomplete markets is like a typical <u>second best situation</u>."

4. Analytical problems with market universalism

Richard Lipsey and **Kelvin Lancaster** (1956) “The general theory of second best”**:**

When one or more optimality conditions cannot be satisfied, it is possible that the next-best solution means moving away from optimality.

If it is infeasible to introduce a well-functioning market in any part of the system, then further market restrictions may partially counteract that omission, and lead to a more efficient outcome.

There is no “one-size-fits-all” policy solution where the removal of market impediments always brings efficiency or welfare.

4. Analytical problems with market universalism

It is not possible for markets to embrace everything: in particular there cannot be markets for all information or all rules.

A problem with market universalism is that missing markets are often overlooked or denied.

5. Policy temptations of market universalism

(A) Market universalism removes conceptual barriers to pushing actual non-market arrangements towards genuine market mode.

(B) Through notions such as “political markets” and “markets for laws”, market universalism conceptually dissolves the state and its legal system into a marketized vision of society.

5. Policy temptations of market universalism

Enlightenment thinkers distinguished civil society from the state, and they saw it as more than trade or business alone.

The idea of **civil society** was characteristic of the classical liberalism of **John Locke**, **Adam Smith**, **Adam Ferguson**, **Thomas Paine**, **Alexis de Tocqueville**, **John Stuart Mill**, and others.

5. Policy temptations of market universalism

Civil society: a social realm of property-owning citizens, who interact under the rule of the state and its laws.

In most accounts it includes private business and markets, *but it is not reducible to them*.

As well as trade unions and employer associations, it embraces many forms of social association (including recreation, religion and philanthropy) that are *not driven by business interests*.

5. Policy temptations of market universalism

Market universalism conceptually undermines the distinctiveness and autonomy of civil society:

Civil society is reduced to matters of property and contract.

5. Policy temptations of market universalism

Previous liberal thinkers had defended individual rights to private property, other human rights, and institutions such as **democracy**.

By contrast, market universalism may promote <u>control over property</u> first, on the grounds that it is the foundation of all other rights and liberties.

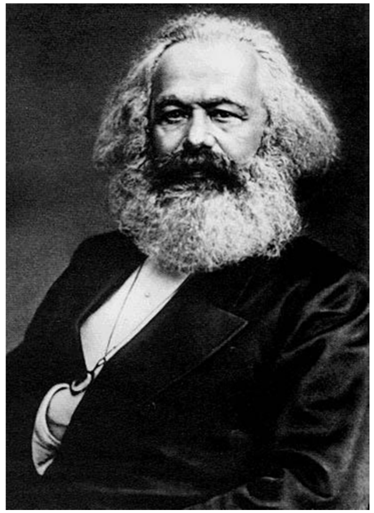
Property moves from being a necessary condition of liberty, to being necessary *and sufficient* for the same.

5. Policy temptations of market universalism

The “political market” may suggest that market criteria become the overriding means to legitimize democracy.

Democracy may be seen as secondary or expedient, especially when property or markets are perceived as being under threat.

5. Policy temptations of market universalism



Similarity with Marxism:

Karl Marx (1843): "*Practical need, egoism,* is the principle of civil society … The god of *practical need and self-interest* is *money*"

Hence for **Marx** "the anatomy of civil society is to be sought in political economy'"

Frederick Engels (1886) wrote that under capitalism "the State – the political order – is the subordinate, and civil society – the realm of economic relations – the decisive element"

But **Antonio Gramsci** had a more sophisticated view of civil society.

5. Policy temptations of market universalism

While Marxist theory dissolves the conceptual distinction between civil society and the state, Marxist regimes have dissolved it in practice.

6. Conclusions

By reasonable criteria, involving minimal attention to the institutions and rules involved in a world of contracts a trade …

… the term *market* is miss-used in instances such as “markets for ideas”, “political markets”, “markets for laws”, “internal markets” etc.

Important to be clear what arrangements are *not* markets.

6. Conclusions

Not everything can be traded on a market – there are inevitable missing markets, such as futures markets for wage labour.

This implies that there is *no universally applicable policy approach* – such as ‘more markets’ or ‘less markets’.

By treating democracy as a market, the further <u>temptation</u> is to regard markets as generally more important than democracy.