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The Coxford Lecture

Do Markets Drive Out Traditional Values?

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1. Introduction

There are many goods and services that we do not permit to be distributed through markets. For example, in the United States individuals are permitted to buy and sell cars and shirts, but market exchanges of votes and sex are banned. In the majority of countries around the world, the sale of kidneys is illegal. Political philosophers have given various arguments about the kinds of things that can legitimately be distributed through markets and I have explored these arguments elsewhere in my work.[1]

Here, I explore a different concern: that markets can undermine the traditional values and motivations upon which a liberal society depends. Markets do this through producing human motivations as well as goods and services. If this is correct, then this consequence gives us reason to protect non-market spheres of life. This concern finds little place in standard economic models. However, an earlier tradition—which includes Adam Smith as well as Karl Marx—addressed the corrosive effects of economic incentives on non-market values. In this paper, I will assess their earlier arguments and examine the contemporary evidence that markets provide individuals with incentives to be self-centered, unreliable and base.

To be sure, it is not new to claim that markets, if they are to function well, must be embedded in a larger social order based on civic virtues such as trust and altruism. This insight is found in Karl Polanyi's *The Great Transformation*,[2] as well as in the writings of John Maynard Keynes and Joseph Schumpeter. It was central to the classical political economy of Adam Smith and J.S. Mill. However, this insight has been lost, until quite recently. Economic theory has claimed that, at least under ideal conditions, minimally regulated markets produce and support efficiency, individual freedom and social stability. There has been little attention paid to the possibility that markets might erode the civic virtues on which they depend.

While this paper touches on themes taken up in my Coxford lecture, given at the University of Western Ontario on March 9, 2017, what is developed here differs somewhat from what was presented in that lecture. I am grateful to my hosts during that lecture, and to the participants and to the editor for helpful comments.

1. See Debra Satz, *Why Some Things Should Not Be For Sale: The Moral Limits of Markets* (Oxford University Press, 2010).
2. Polanyi argued that a market society—an economic system controlled, regulated and directed by markets alone—would necessarily undermine itself. See *The Great Transformation* (Beacon Press, 1971). In addition to Polanyi, my thinking on markets and their relationship to motivation has been importantly influenced by Samuel Bowles, *The Moral Economy: Why Good Incentives are No Substitute for Good Citizens* (Yale University Press, 2016); Elizabeth Anderson, "The Ethical Limitations of the Market" (1990) 6:2 Economics & Philosophy 179; and Richard Titmuss, *The Gift Relationship: From Human Blood to Social Policy* (Pantheon Books, 1971).

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This essay is organized in three sections. First, I examine the importance of the fact that markets are incomplete because no market will ever be able to specify claims contingent on every possible state of the world.[3] It follows that efficiency itself depends on setting some constraints on individual self-interest. Second, I describe and respond to two rationales for minimal market regulation: (1) that markets promote individual autonomy, and (2) that markets foster stable social cooperation. Third, I discuss the implications of my argument for social policy.

There is one important caveat to my argument. This paper is not meant as an 'all things considered' assessment of the role of markets in society. Markets have clear beneficial effects and currently we know of no mechanism for inducing innovation on an economy-wide basis that is as powerful as market competition. Nevertheless, if markets crowd out ethical motivations, and thereby have effects on social stability through influencing the likelihood of cooperative behavior, then it is important to consider ways of bringing such motivations back in.

2. Even Ideal Markets May be Inefficient

Until the early 1970's, most economics textbooks presented a model in which markets are efficient, transaction costs are zero, each participant has complete information and acts solely on the basis of their rational self-interest. According to this model, markets foster the improvement of everyone's initial position, because if a trade is disadvantageous, a rational individual will forgo it. Markets, therefore, lead rational individuals to produce, as an unintended consequence of their personal action, collectively good results: markets make everyone better off. In doing so, markets are instrumental in realizing Mandeville's famous aphorism (1704): they harness "private vices" to "public virtues." In more technical terms, the fundamental theorem of welfare economics asserts that under certain assumptions (e.g., markets are complete and there are no economies of scale), competitive markets will support a Pareto optimum, a social state in which no one's utility can be raised without reducing the utility of someone else.[4]

Standard textbook theorems, connecting markets and efficiency, were then coupled with a theory identifying "market failures," circumstances in which the utility enhancing effects of markets are inoperable or eroded. According to this theory, markets fail when certain features of an exchange—which economists call "externalities"—are not accounted for by individual agents. Externalities are the effects—the costs or benefits—of a transaction that are not fully absorbed by the exchanging parties but passed on to third parties. In some circumstances, these external costs constitute public bads: the defacement of the landscape,

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3. KJ Arrow, "The Role of Securities in the Optimal Allocation of Risk-Bearing" (1964) 31:2 Rev Economic Studies 91.

4. Pareto optimality defines a conception of efficiency in terms of individual utilities. Because Pareto optimality looks only to such utilities and ignores distributional considerations, it has weak moral implications. Depending on the initial starting distribution of assets and endowments, a Pareto optimal state can be a state of social misery and inequality. Simply consider the case in which the utility of the downtrodden cannot be raised without lowering the utility of the millionaires.

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pollution, and urban decay are notable examples. The existence of public bads, in turn, is taken to justify political responses. Therefore, from the perspective of the pre-1970's economics textbook, political institutions are justified when fully efficient markets for the distribution of certain goods cannot be established. Political institutions are thus "second best" solutions to problems whose existence presupposes market failure.[5]

One important point about the theory of market failure: if the externalities of market transactions could be internalized, that is, if markets in these effects could be created, then a perfect market could be reconstructed. One way to do that is to expand the scope of the market—to put the right to pollute or to despoil the environment up for sale. As Elizabeth Anderson has noted, market failure is not a theory of what is wrong with markets but what goes wrong when markets are not available.[6]

Critics have long pointed to the discrepancies between real world markets and the fictitious perfect markets found in economic textbooks. The seeming omnipresence of market failure—the widespread existence of monopoly and involuntary unemployment—raises serious concerns about the empirical adequacy of ideal market theory.[7] And starting in the early 1970's, one of the key assumptions of this theory—the idea that all markets could be complete—was increasingly questioned from within economics itself.[8]

Complete markets occur when every agent is able to exchange every good with every other agent: each agent owns all the benefits and costs of her actions, including the third-party costs and benefits. But what happens if the costs and benefits of a good are not—and cannot be—fully known, or if one agent has more information about them than another agent?

Consider a standard labor contract in which an employer agrees to hire a worker for a certain wage. How hard is the employee required to work? This cannot be completely specified but depends on information that is not transparently available. In such cases, the parties have to rely on other factors: honesty, a positive work ethic, a commitment to keep promises, and the like.

In many economic models, self-interest alone is said to motivate human behavior. But when we examine behavior in incomplete markets, we realize that agents cannot rely only on self-interest. If self-interested individuals are not bound by anything except insofar as it enhances their own utility, why should they not lie about how hard they can work? Why should a self-interested individual keep their promises? Economic individuals driven only to maximize their own utility have incentives to manipulate information and outcomes in ways

5. Consider the striking claim that "morality arises from market failure" by David Gauthier in *Morals By Agreement* (Clarendon Press, 1986) at 84.

6. Anderson, *supra* note 2.

7. Real markets depart from ideal conditions due to many factors, including (1) non-zero transaction costs; (2) "natural" monopolies; and (3) the absence of perfect information among producers and consumers.

8. George Akerlof, "The Market for 'Lemons': Qualitative Uncertainty and the Market Mechanism" (1970) 84:3 Quarterly J Economics 488; Carl Shapiro & Joseph Stiglitz, "Equilibrium Unemployment as a Worker Discipline Device" (1984) 74:3 American Economic Rev 433.

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that will ultimately undermine market efficiency. They can do this by acting as though they were willing to pay less for goods and services than they really are, or by threatening to withdraw from a trade entirely.[9] Consider that if all employees worked to the best of their ability, employers would not have to rely on costly supervision to extract the same amount of effort. Economic individuals need to be restrained from taking advantage of the opportunities for deception that arise because many markets are, and must be, incomplete.

Because many markets are incomplete, markets must rely on non-market institutions, including contract law, firms, unions, and political states. But beyond these institutions, they must depend on the civic virtues of honesty, trust, altruism and cooperation, all of which constrain maximizing self-interest. This transforms the neoclassical view. Political institutions and altruism no longer appear as "second best" solutions to market failure; they are theoretically on par with market competition. Even in cases where markets do not fail, cooperative norms and institutions are presupposed.

In sum, markets must rely on some traditional virtues if they are to function well. But what if markets also undermine these values? In the next section of this paper, I examine two arguments for leaving markets alone to do their work, eschewing help from the state. I will then examine how the empirical evidence, of the effects of markets on the traditional virtues, affects these two arguments.

3. Markets and values

A. Autonomy

Consider the claim that "free markets embody the liberal ideal of autonomy."[10] Protecting autonomy is a central reason that is often given to justify non-interference in markets. Let us call a person autonomous if and only if they govern their own life according to norms and principles that they are prepared to endorse upon reflection. This is a complex idea—the practice of autonomy weaves together different capacities that people have[11]—but its general outlines are clear. An autonomous person makes choices, and so autonomy requires the existence of genuine options and an absence of coercion. It also requires an ability to understand the significance of one's choices (including the ability to weigh costs and benefits) and to affirm those choices in the light of one's considered judgment.

Proponents of non-interference in markets cite a range of important effects that markets have on an individual's ability to develop and exercise the capacity for autonomy. Each of these effects, they argue, depends on leaving the market domain largely cordoned off from political interference.

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9. For discussion of cases of incomplete contracts, see Akerlof, *supra* note 9; Samuel Bowles & Herbert Gintis, "The Revenge of *Homo Economicus*: Contested Exchange and the Revival of Political Economy" (1993) 7:1 J Economic Perspectives 83; Shapiro & Stiglitz, *supra* note 9; Oliver Williamson, *The Economic Institutions of Capitalism* (The Free Press, 1985).

10. See Jules Coleman, *Risks and Wrongs* (Cambridge University Press, 1992) at 67.

11. These capacities include, but are not limited to, capacities of understanding, valuing, imagining, and reasoning.

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Markets support autonomy in several ways. Markets: (1) present agents with the opportunity to choose between a range of alternatives; (2) provide incentives for agents to anticipate the results of their choices and thus foster instrumental rationality; (3) decentralize decision making, giving to agents alone the power to buy and sell goods and services without requiring them to ask anyone else's permission or take anyone else's values into account; (4) place limits on the viability of coercive social relationships by providing relatively unimpeded avenues for exit, (5) decentralize information, (6) (may) enhance individuals' sense of responsibility for their choices and preferences, (7) allow people to practice and try out various alternatives and (8) create the material wealth which is a precondition for the possibility of having significant alternatives.[12]

There is something appealing about this picture of the market realm where the capacity for individual choice is developed. Indeed, respect for markets in diverse goods and services constitutes an important way of respecting individual (and divergent) conceptions of value. In a market system, there is no preordained pattern of value to which individuals must conform,[13] and a system of market exchange gives to individuals the freedom to pursue distinct aims. However it would be a mistake to conclude on the basis of this picture that the competitive market is a "system of natural liberty,"[14]—a self-regulating structure of the mutually compatible actions of autonomous individuals.

If autonomy means governing one's life according to values that one can reflectively endorse, then markets may sometimes preclude or diminish an agent's autonomy. The most obvious cases are markets in goods that undermine the capacity for choice itself, for example, voluntary slavery contracts.[15] Participation in other markets (e.g., addictive drugs), can preclude an agent's ability to act autonomously in the future. In these cases, agents may want some of their preferences to be left unsatisfied in the light of their overall judgments about the kind of person they wish to be.

In response, and perhaps exempting these extreme cases, some theorists emphasize the importance of allowing the most extensive range of choice possible. They argue that adding an option to a list of choices in the market can never diminish an agent's autonomy; when faced with the choice to sell myself into slavery or not, it is always possible to choose to remain free.

B. Stability

An alternative argument to support limiting the restrictions we impose on markets emphasizes their contribution to social stability. This rationale has a long

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12. For further discussion, see Satz, *supra* note 1 at 15-39.

13. This is not true, strictly speaking. In order to function, markets require some underlying system of property rights that everyone is committed to (although perhaps not for the same reason). The point is that the extent of these underlying rights is supposed to be minimal and compatible with highly divergent conceptions of value.

14. See Adam Smith, *The Wealth of Nations* (Modern Library, 1937).

15. Orlando Patterson, *Slavery and Social Death* (Harvard University Press, 1982) documents such cases of voluntary self-enslavement). See Robert Nozick, *Anarchy, State and Utopia* (Blackwell, 1974) for an explicit defense of the right of people to enslave themselves.

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history. Eighteenth century theorists saw markets as instruments for channeling and counteracting those individual passions like greed and glory that threatened stable social order. Montesquieu, for example, celebrated the moderating effects of commerce on human character: "commerce…polishes and softens barbarian ways as we see every day."[16]

These theorists view commerce and trade as injecting elements of calculation and prudence into human behavior. In Adam Smith's well-known words, "It is not from the benevolence of the butcher, the brewer, the baker, that we expect our dinner, but from their regard to their own self-interest." Not only do markets channel greed into economic growth and opulence, but they also promote cooperation. While much has been made of Smith's invisible hand steering passions in the direction of efficient economic growth, most commentators have missed a crucial *social* dimension of Smith's celebration of the market: markets can achieve social order (undercutting the collective action problems that arise in most alternative forms of organization) without having to resort to a tyrannical despot. They are not simply engines of productive expansion, but also regulators of stable social cooperation among free individuals.

I will call this the market stabilization thesis: markets tend to produce social stability—an equilibrium among cooperating individuals who disagree with one another about how to live. The emphasis on diversity is important, since stability might not always be a good thing—for example, when stability is achieved through coercion or repression. It is the contribution of markets to liberal social order—to free cooperation among individuals with different values—that many market advocates defend. Hayek is the most important modern proponent of this view. On the Hayekian view, markets are based on conventions, which no individual has consciously designed, but that exist and persist without any external support or political interference. They are products of unconscious evolution, not conscious command. Examples of these conventions include the arrangements by which buyers and sellers make contact; norms providing for first come, first served; knowledge of what makes a part of a city a business district; and how to go about finding a job.

Much can be said on behalf of the market stabilization thesis. Millions of decentralized and uncoordinated market acts function largely in an orderly way. The milk arrives in the supermarket, the paper in the stationery store, all without the existence of a central plan. Information is spread by the price system. You and I need not agree about the value of milk or paper to engage in mutually beneficial cooperation.

I contend that these two arguments—from autonomy and from stability—depend on a certain persistence of traditional civic values. To make my case, let us examine the empirical evidence that markets effect motivations in ways that undermine civic values.

Consider the following real-life experiment. Faced with parents who habitually arrived late to pick up their children at the end of the day, six Haifa day care

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16. Quoted in Albert Hirschman, *The Passions and the Interests: Political Arguments for Capitalism Before its Triumph* (Princeton University Press, 1977) at 60.

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centers imposed a fine for such parental lateness. They hoped that the fines would give these parents a self-interested reason to arrive on time. The parents responded to the fine by *doubling* the amount of time they were late. Even when the fine was revoked three months later the increased lateness continued. One plausible interpretation of this result is that the fine undermined the parents' sense that they were morally obligated to not take advantage of the day care's workers; instead they now saw their lateness as a commodity that could be purchased.

This type of result has been replicated in carefully designed experiments in the laboratory and in other contexts. The experimental economist Bruno Frey has examined circumstances where *intrinsic motivation* is partially destroyed when price incentives are introduced. An action is intrinsically motivated when it is performed simply because of the satisfaction the agent derives from performing the action. Whereas conventional economic analysis assumes that offers for monetary compensation will increase the willingness to accept otherwise unwanted projects, Frey found that support for building a noxious nuclear waste facility in a neighborhood actually *decreased* when monetary compensation to host it was offered. His study suggests that in cases where individuals are civically minded, using price incentives will not increase but can actually decrease levels of support for civic actions. For an intrinsically motivated agent, performing an act for money is simply not the same act as when it is performed for free. The presence of monetary incentives can crowd out a person's intrinsic reasons for performing the given action, changing the attractiveness of the options faced. For example, in the nuclear waste example, citizens may feel bribed by the offer of money. In the case of timely day care pickup, altruistic concern for the teachers may be replaced by self-interested calculation about the worth of avoiding the fine.[17]

It is worth emphasizing that this kind of crowding-out of altruistic motivation is not an inevitable consequence of price incentives; the market can also be harnessed in a socially beneficial way. Nevertheless, if these case studies are illustrative, markets have the ability to change social norms. And if introducing a market does affect intrinsic motivations, we cannot a priori predict in which direction the net change of behavior will go. Still, the experimental evidence does show a bias to anti-social behavior when market incentives are introduced.

One interesting example to ponder concerns the teaching of market logic to undergraduate students. A study by Gerald Marwell and Ruth Ames found that students of economics are much more likely to free-ride in experiments that called for private contributions to public goods. Their basic experiment involved a group of subjects who were given an initial endowment of money, which they were to allocate between two accounts, one "public," the other "private." Money deposited in a subject's private account was returned dollar for dollar to the subject at the end of the experiment. Money deposited in the public account was first pooled, then multiplied by some factor greater than one, and then distributed equally among all subjects.

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17. See Bruno Frey & Felix Oberholzer-Gee, "The Cost of Price Incentives: An Empirical Analysis of Motivation Crowding Out" (1997) 87:4 American Economic Rev 746.

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Under these circumstances, the socially optimal behavior is for each subject to put their entire endowment in the public account. But the individually most advantageous strategy is to put all of it in the private account. The self-interest model predicts that all subjects will follow the latter strategy. Most do not. Across eleven replications of the experiment, the average contribution to the public account was approximately forty nine percent. It was only in a twelfth replication with first-year graduate students in economics as subjects that Marwell and Ames obtained results more nearly consistent with the self-interest model. These subjects contributed an average of only twenty percent of their initial endowments to the public account, a figure significantly less than the corresponding figure for non-economists.[18] The gap between economics and non-economics students was found to obtain in repeated trials.

These results have important implications for the replacement of public means of decision-making—whether through law or deliberation—with market mechanisms. Privatization is one means through which that may happen. Privatization should not be seen only as having effects on the production and distribution of some particular good—it may turn out to have feedback effects on the kinds of preferences that agents have. And these changed preferences may affect the kinds of outcomes that are possible.

For example, we can contrast two models of distributing primary and secondary education. In the first model, children are allocated to public schools so that each school will be representative of the social class and ethnic mix of the local area. In the second model, schooling is distributed in the form of individual vouchers or cash that can be used at the schools—public or private—that parents most prefer. Arguments about school choice are complicated, but I think that we have at least one reason to be wary: private goals, in this context, can diverge from, prevent, and undermine, the state's interest in achieving social integration.

The divergence arises in this case because parents generally care about the best interests of their own children, and as individual decision makers, they tend to prioritize those interests. Indeed, in one sense, it is entirely appropriate that they do so: society relies on parents to act as trustees for their children and to do what conduces to their children's flourishing. At the same time, parents can prioritize their own children in ways that can lead to worse outcomes for other children and to the furthering of educational inequities, as well as to other social ills like instability and conflict. Thus, studies have shown that "choice" programs are more racially segregated than non-choice mechanisms for allocation.[19]

It follows then that the more parents act as individual decision-makers for their children with respect to school choice, the harder it is for other parents to act on the goal of integration. And no individual parent can bring about goals such as ending racial and class divisions, or maintaining social stability, by acting on his or her own, independently of others.

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18. Gerald Marwell & Ruth Ames, "Economists Free Ride, Does Anyone Else? Experiments on the Provision of Public Goods, IV" (1981) 15:3 J Public Economics 295.

19. Jack Dougherty, "Shopping for Schools: How Public Education and Private Housing Shaped Suburban Connecticut" (2012) 38:2; J Urban History 205.

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Suppose, then, that the existence of a market does indeed undermine traditional civic virtues. What are the implications of this for the two market defenses I have been considering?

To begin, consider how the empirical literature on "crowding out" is relevant to the argument that respecting autonomy requires giving wide berth to market choices. Recall that autonomy involves agents acting on choices that they reflectively endorse. The critic of market regulation points out that in a well-functioning market, agents have the choice as to whether or not they participate in a particular market.[20] Implicit in this view is the idea that introducing a market into a social sphere not previously governed by markets, simply adds another choice to an individual's set of options. Kenneth Arrow makes use of this claim in his argument with Richard Titmuss over the possible benefits of a market for blood.

Titmuss compared the British system, where blood is not sold but given freely, to the American system in which a substantial amount of blood is purchased from individuals who make money by selling it.[21] Titmuss made two arguments in favor of the system of donation. The first was that a market yields blood of lower quality. A crucial part of this argument concerns the differing motivations between those who give blood as a gift and those who sell it for a price. Altruistic donors have no incentive to lie about the quality of their blood, while commercial donors clearly do. Thus, commercial systems the quality of blood would be poorer. Second, Titmuss argued that over time, a blood market drives out altruism by turning the "gift of life" into the monetary equivalent of fifty dollars. People will become less willing to give blood freely as market distribution becomes more prevalent, for their gift now loses its benevolent meaning.

Arrow accepted Titmuss' point about the quality of blood but objected to the idea that a market would depress quantity. Because the creation of a market increases the individual's set of choices, it results in higher benefits. If we add the possibility of selling blood to a voluntary blood donor system, we have only expanded the individual's range of alternatives.

"If he derives satisfaction from giving, it is argued that he can still give, and nothing has been done to impair that right."[22]

However, it turns out Arrow was wrong. Titmuss' conjecture is now empirically supported by numerous studies showing that financial incentives can crowd out altruism and other pro-social motivations.

If we turn from the empirical effects of markets on human motivations to their effects on the goods that they distribute, we can see other ways in which markets may undermine the values that an agent reflectively endorses. The very choice to allow market sales in some goods and services precludes certain relationships, practices and values.

For example, democracy requires that individuals be restricted from engaging in the sale of votes, even if some people would choose to sell their votes. A

20. This assumes the absence of monopoly and the ability of a person to have the effective freedom to withdraw from any particular exchange.

21. Titmuss, *supra* note 2.

22. KJ Arrow, "Gifts and Exchanges" (1972) 1:4 Philosophy & Public Affairs 350.

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commitment to gender equality might lead someone to endorse restrictions on markets in women's reproductive labor or sex. These examples underscore the point that more choice does not imply increased autonomy when the addition of an option destroys the choice an individual would endorse on reflection.[23] More choices can eliminate better choices, and choices made now can constrain opportunity sets later. (Consider the role of minimum wage laws and prohibitions on vote selling from shrinking people's opportunity sets over time.) Desiring autonomy may therefore lead us to restrict the scope of choice and, analogously, the market.[24]

My arguments that markets do not necessarily promote human autonomy require some qualification. Even if markets interfere with, or fail to promote, certain kinds of freedom, interference with them might be more damaging to autonomy overall. Perhaps the only feasible institutional alternatives to unregulated markets all involve significant amounts of coercion.

The point, however, remains: treating markets as outside of human control may preclude or diminish autonomy. It may prompt us to form preferences that will shape us in the wrong way—developing preferences whose satisfaction we would reject upon reflection. Indeed, markets may corrupt the way we form preferences by making us less aware of phenomena to which we should be responsive. For example, markets may erode our appreciation of the values of solidarity and political life more generally.

Finally, we can note that nothing in economic theory guarantees that a particular market equilibrium will satisfy basic human needs. And, when people are deprived of the means of securing their subsistence, they often turn to violence, which in turn, undermines social stability.[25]

Indeed, for the stability thesis, the results of the empirical evidence are devastating. To see why this is so, we need to go back to the point I underscored at the beginning of this paper: it is impossible to organize a complete market. All real markets will require some resources for the costs of bargaining, monitoring, and enforcing any given transaction—for example, employers must monitor workers, and lenders must monitor debtors.

If the costs to transactions are low, agents may be able to pay them without resorting to an external coercive agent such as a political state. What makes transaction costs low? What factors bear on whether a group of individuals will be able to pay such costs internally without having to rely on outside parties? My claim is that markets tend to have long term effects on the agents who participate in them such that the transaction costs borne by these agents tends

23. Indeed, given that it takes time to process the merits of competing options, increasing the number of alternatives may not always translate into the best environment for choice. A world in which I have to consider choosing among one million brands of toothpaste is not preferable to a world in which there are only four brands. See Gerald Dworkin, *The Theory and Practice of Autonomy* (Cambridge University Press, 1988).

24. Of course there may be times when more options enhance the value of the best option. Some people have claimed, for example, that prostitution enhances (or at least, does not debase) the value of romantic love.

25. In conversation, Elizabeth Anderson has stressed to me the importance of thinking about the relationship between basic need provision and stable social order.

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to rise. Markets can thereby produce instability; under the changed conditions of rising transaction costs (brought about by the operation of the market itself) individual agents will benefit more from withdrawing from an exchange than from cooperating; their cooperation will therefore require support from non-market institutions.

The key to my argument is the recognition that a cooperative solution among economically rational individuals depends on various factors that are causally affected by the operation of markets themselves. These factors include (1) the extent of shared beliefs and preferences among individuals; (2) the expectation that given individuals will continue to interact with one another in the future (i.e., that membership in the group is more or less fixed) (3) the duration and nature of the cooperative activity (i.e., do individuals engage in long term and face-to-face interactions with each other?); (4) the respective rewards for cooperation and defection and (5) the extent of individuals' abilities to communicate with one another.[26]

These five factors affect the ability of agents to manage the transaction costs of their exchanges. Factors (1) to (3) help to reduce the various kinds of uncertainty from which the transaction costs derive. As the heterogeneity and number of trading partners increases, monitoring and enforcement costs also increase. Factor (4) concerns the payoffs to cooperation, which influence an individual's decision. Factor (5) helps lower bargaining costs because communication makes it easier to identify points of agreement, compromise and compensation.

Markets have effects on these factors. The anonymous nature of market exchanges tends to favor short-lived exchanges (factor 3) and a pairing of individuals that is more random than in a small community of friends (factor 2). In a market, the parties can freely switch between partners in making an exchange, sensitive only to the net benefits that different deals bring.[27] Markets coordinate the activity of vast numbers of people who need not share any fixed set of values (factor 1). Indeed, the logic of a market is to integrate larger and larger numbers of people into its framework and to overturn local barriers to economic interdependence by enabling people to exit.[28]

By opening up numerous possibilities for "exit", markets reduce the benefits associated with the provision of a cooperatively provided good (e.g., I can substitute a private security system for a safe neighborhood, and so obtain the benefits for myself without sharing them). When an individual is dissatisfied with the provision of a public good, they are able to simply withdraw and satisfy their desires in private consumption of the good. The ability of individuals to secure goods independently of their community erodes incentives for internal participation in

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26. These factors overlap in partial ways with factors highlighted by Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Action* (Cambridge University Press, 1990); Michael Taylor, *The Possibility of Cooperation* (Cambridge University Press, 1987); and Michael Taylor, *Community, Anarchy and Liberty* (Cambridge University Press, 1982).

27. Unfortunately, not all desirable values work together. The anonymous nature of market exchange, which economists from Milton Friedman onward rightly celebrate as a fetter on discrimination, also serves to diminish the degree of social solidarity and community.

28. It is a serious gap in neoclassical economics that the size of the population is not treated as endogenous to its models.

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efforts to improve a common life. This, in turn, can lead to diminishing rewards for cooperation (factor 4).

Markets further increase the costs of providing for cooperative outcomes by discouraging the capacities of common information pooling and public deliberation (factor 5). Markets place motivational impediments on the collective sharing of information: communication can be costly and time consuming and its rewards to any particular individual may be low. In addition, the costs of public deliberation increase with its decreasing frequency, since it is more costly to engage in public reasoning if I am unaccustomed to it. (Think of how the costs of delivering lectures go down with frequent preparation.) By providing cheap substitutes for the time-consuming development of social virtues, markets may progressively erode skills of compromise and restraint. In Albert Hirschman's terms, markets tend to favor "exit" over "voice."[29]

These problems with markets are surmountable.[30] Many of them can be attenuated where markets are embedded in a larger social order that encourages norms of reciprocity among equals, sharing and honesty. Persons consciously oriented to the common good will be less likely to defect, and more willing to pay the costs of the provision of goods in common. By designing institutions such as producer's associations, neighborhood councils and advocacy organizations, all of which encourage "voice" as well as "exit," we can decrease the costs of implementing cooperative norms to some extent.

Of course, we could reduce transaction costs by restricting people's movement from one neighborhood to another or by forcing people to accept the same religion. These restrictions would tend to increase the number or encounters between people and make the population more homogeneous. Furthermore, these restrictions might be compatible with the efficiency properties of the market. But each would be an illegitimate infringement of a basic human liberty, and a violation of the principles of a liberal social order.

Instead, I propose two types of market restrictions to raise the extent of a community's internal resources, neither of which, violates a fundamental human liberty: restrictions on the alienation or transfer of property, and restrictions on the degree of inequality generated by accumulation of property. Each of these restrictions aims at embedding markets in a social order with a higher degree of community than laissez-faire capitalism allows. Each of these restrictions goes beyond the requirements of efficiency—embedding markets more deeply into the surrounding social order and directly attempting to foster (and to institutionalize) individual concern for the well-being of others.

By laissez-faire capitalism, I mean an economic system in which the means of production and the ability to labor are privately owned and there are markets in

29. "Voice" and "exit" are not simple terms of opposition, however. Sometimes the threat of exit will give power to voice. More generally, an exit option places limits on the extent of extortion by others. See Albert Hirschman*, Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations and States* (Harvard University Press, 1970).

30. It is important to distinguish my largely consequentialist argument from an alternative argument which rejects the use of markets in certain domains categorically. I express my reservations about this kind of argument in Satz, *supra* note 1.

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both. While markets are not unique to the system of laissez-faire capitalism, this system uniquely expands the market to cover all productive assets of a society, including the human ability to labor.[31] In such a system, all production is in principle, if not in fact, for sale on the market. Laissez-faire capitalism gives to private individuals the disposition to do with their productive assets what they wish (within certain minimal legal and contractual limits). Specifically, individuals can hire out their talents for a price and they can transfer their external property to others and fully liquidate their property when they desire.

The minimally regulated and broad ranging markets that laissez-faire capitalism relies on tend to erode the bonds of a common life. Such markets allow individuals to invest in communities to which they have no commitment except that needed for making a profit. Absentee owners need not be concerned with the consequences of their trades on the local environment: corporations facing lower profits or exhausted resources simply move their plant elsewhere. These markets encourage a view of assets and wealth in terms of their trade value alone rather than as an important component in a shared way of life. Moreover, unregulated markets generate inequalities that break down the bonds between people; as individuals become less alike, so too the possibility of a life in common recedes.

Restrictions on the transfer and accumulation of wealth have an important legacy in American politics. William Simon (1991) has referred to the property created by such restrictions as "social-republican property." While social republican property is owned by individuals, it cannot be sold to anonymous outsiders. Owners must be active participants in the community that is constituted by that property. Furthermore, the inequality between members of the community is limited. As an early example of this kind of property, Simon considers the Homestead Act of 1869, which tied the ownership of a land parcel to an individual's commitment to settle, cultivate and occupy it.[32] Each individual family was given an equal unit of land. These two restrictions—on sale and accumulation—lower transaction costs by securing the tie between an individual and society.

I have argued that markets need embedding. In the real world there is no reason to believe that the values that markets would reinforce in equilibrium would be the values needed to sustain markets. Not only might markets promote values of deception and manipulation, as I outlined above, but they might cultivate corporatist or paternalist values or reinforce racial and gender divisions. For these reasons it is crucial that economists take seriously the effects of markets on human motivations and values.[33]

Even if the self-regulating market were feasible, there would be reasons to reject it as an ideal. I have already argued that the value of individual autonomy may give us reasons to restrict the scope of markets. Beyond their effects on autonomy and stability, there are other reasons for placing markets within a nexus of social institutions that restrict their scope and nature. Any plausible

31. See Polanyi, *supra* note 2.
32. See William Simon, "Social Republican Property" (1991) 38 UCLA Law Rev 1335.
33. For an argument that some instability is good for human happiness, see Tibor Scitovsky, *The Joyless Economy* (Oxford University Press, 1976).

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moral or political theory will object to the use of markets in certain domains, even if such use enhances social stability (and even if this stability is associated with individual autonomy.) Political theory is concerned with a plurality of values—not only with welfare, stability and autonomy but also with solidarity, respect, fairness, and altruism. Market competition, even if it were stable and efficient, might erode some of these values, such as the value of altruism or the self-respect of those who fail to do well. Universal markets might drive out various values (e.g., altruism or trust) while destroying others (e.g., love or the possibility of political equality).

In evaluating the self-regulating market ideal we need to ask: are people entitled to use and exploit each other, as they use and exploit other natural objects, as long as this exploitation is compatible with market-generated Pareto improvements? What are the consequences of treating labor markets as we treat shirt markets? What kinds of people would such labor markets produce? What kind of society?

4. Conclusion

I have examined here the consequences of market incompleteness for efficiency, autonomy and stability. I argued that each of these values requires embedding markets in a larger social order. A full consideration of markets must consider the relation between markets and a wider set of values. There are many values that our institutions serve; some may be supported by markets, while others may be undermined. For example, the tendency of markets to undercut invidious distinctions must be weighed against the tendency of markets to erode solidarity and participation.

Nothing that I have said is meant to dismiss the necessary and desirable aspects of markets. Markets do more than produce an efficient distribution of goods and services. They also help produce a social order of a certain kind—one that we can call liberal. They help form individuals who are end seekers, coaxed by market signals to consider the relative costs of pursuing different goals. Markets also allow such individuals to cooperate without having to agree on a large range of questions of value.[34]

But I believe that the self-regulating market celebrated by Hayek and others is no substitute for a complex social order, governed by explicit deliberation about the common good, including deliberation about the scope of the market. Markets shape people as well as distribute goods; sometimes markets (and even the use of market theory) shape people in the *wrong way*. When we allow markets into certain domains, we make a choice of who we are and who we will become, a choice that has consequences both for economic efficiency, for our autonomy and for our future ability to cooperate at all.

34. The disciplining function of markets is also an important aspect of markets that has only recently received attention.

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