

A PROPOSED DEFINITION OF MARKET ECONOMY

In this post, I give a proposed definition of the term “market”:

A market is the set of social arrangements under which people buy and sell specific goods and services at a specific point in time.

Social arrangements means all of the things that constrain and organize human action, including laws, regulations, social expectations, conventions, and standards, whether created or enforced by governments, institutions or local traditions.

With this definition in mind, how should we define the term “market economy”? To start with, my definition is meant to contrast with other definitions discussed in this post, and particularly that of Samuelson and Nordhaus, *Economics*, 2005 ed. p. 26.

A market is a mechanism through which buyers and sellers interact to determine prices and exchange goods and services.

That definition forms the basis for their definition of the term “market economy”:

A market economy is an elaborate mechanism for coordinating people, activities, and businesses through a system of prices and markets. It is a communication device for pooling the knowledge and actions of billions of diverse individuals. P. 26.

The terms market economy and free market economy are used by people to describe the economic

system in the US. Many people are committed to the belief that free and untrammelled markets are intricately and intimately bound up with political and personal liberty. Milton Friedman is one such: here is a link to a short 1961 essay in which he explains his views. Friedman contrasts capitalism with socialism. He tries to imagine how such a socialist country might convert to capitalism. In such a country, he explains,

The first problem is that the advocates of capitalism must be able to earn a living. Since in a socialist society all persons get their incomes from the state as employees or dependents of employees of the state, this already creates quite a problem.

Presumably Friedman is talking about the Soviet Union. From this we should conclude that his target is the command and control economy which the Soviet Union and the Socialist Republics of the USSR implemented. Friedman sees the capitalist or free market system as the opposite.

Fundamentally there are only two ways in which the activities of a large number of people can be coordinated: by central direction, which is the technique of the army and of the totalitarian state and involves some people telling other people what to do; or by voluntary co-operation, which is the technique of the market place and of arrangements involving voluntary exchange.

So, it turns out that the definition of a market economy is any economy except a command and control economy. The details about the level of organization and constraint provided by various actors, including but not limited to governments at each level, are details worked out in each society in accordance with local desires. I'm not sure Friedman would approve of my pair of

definitions, though.

This essay is a fascinating glimpse into early neoliberalism. Friedman gives a history of liberalism similar to the one I give here. He contrasts what we call liberalism, associated with the New Deal, with his views which he calls new liberalism, “a more attractive designation than ‘nineteenth century liberalism.’ “ He denounces what he calls “democratic socialism” as a contradiction in terms. He explains that his form of liberalism is like the 19th Century form with its emphasis on “freedom”. He says that 20th Century liberals put the emphasis on “welfare”, meaning the well-being of the members of society, not like Great Society welfare programs. His 20th Century liberal might ask what the point of Friedman’s freedom is, since it apparently isn’t the well-being of the members of society.

I take this to be his central thesis:

It is important to emphasize that economic arrangements play a dual role in the promotion of a free society. On the one hand, “freedom” in economic arrangements is itself a component of freedom broadly understood, so “economic freedom” is an end in itself to a believer in freedom. In the second place, economic freedom is also an indispensable means toward the achievement of political freedom.

For example, if you are forced to participate in Social Security, you have lost a portion of your personal freedom. But, he says, that’s what you expect of pointy-headed liberal intellectuals:

They tend to express contempt for what they regard as material aspects of life and to regard their own pursuit of allegedly higher values as on a different plane of significance and as deserving special attention.

I promise you that I consider my creature comforts more important than my intellectual pursuits, such as they are. Friedman then explains that economic power is a natural opponent of concentration of power in governments. Economic freedom is a necessary but not sufficient condition for political freedom. The rest of the essay is a surprisingly shallow explanation of these ideas. You might have thought that he would at least recognize the danger of concentrated capital for democracy. After all, he wasn't that far removed from the Great Depression, the Palmer Raids, and the horrifying treatment of workers beginning with industrialization. But no. Instead we get this:

If I may speculate in an area in which I have little competence, there seems to be a really essential difference between political power and economic power that is at the heart of the use of a market mechanism to preserve freedom.

This is where he gives his hypothetical about a Soviet Republic that wants to switch to capitalism. It can't happen according to his discussion; but, of course it did. Then he explains how the Hollywood Blacklist was an infringement of the right of suspected communists to earn a living, and how it was destroyed by the demands of the market. Both of these arguments show how right Friedman was to claim little competence. Or perhaps Friedman hadn't focused on the way his ideology limited his conceptualization of complicated issues; a problem every thinker must guard against.

In any event, it seems that we don't need a complicated definition of the term market economy. All it means is any economy that isn't a command and control economy. Anything else is just metaphor, like the communication device conjured up by Samuelson and Nordhaus.