THE MORAL STANDING OF THE MARKET*

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How valuable is the market mechanism for practical morality? What is its moral standing? We can scarcely doubt that as individuals we do value tremendously the opportunity of using markets. Indeed, without access to markets most of us would perish, since we don't typically produce the things that we need to survive. If we could somehow survive without using markets at all, our quality of life would be rather abysmal. It is natural to feel that an institution that is so crucial to our well-being *must be* valuable. And since moral evaluation can hardly be indifferent to our interests and their fulfillment, it might appear that there is nothing much to discuss here. The market's moral standing "has to be" high.

However, the value to an individual of a particular institution when society has been organized around that institution must be distinguished from how the society – and even that person – might have fared had the society been organized differently. We, as individuals, are thoroughly dependent on the market (as things stand), but that does not tell us much about the value of the market *as an institution*. We have to consider alternative ways of doing the things that the market does. The assessment of an institution cannot be based on examining the predicament of an individual who is suddenly denied access to it, without having the opportunity of being in another social arrangement with other types of institutions.

A second difficulty in treating the question as straightforward arises from problems in formulating the nature of the choice that is being considered. When somebody questions the value of the market, he or she is typically not considering the alternative of having no market transactions *at all*. In fact, that is hard even to visualize. Markets, in the widest sense, enter into an enormous range of activities. Some social activities are formal market transactions; others are quite informal; and some have only a few market-type features. Those who rail against the market mechanism are not about to

*I am most grateful to Allan Gibbard for his discussion of the paper following my presentation at Bowling Green on 21 September 1984. I have also benefited from the general discussion, including comments by Jules Coleman, Donald Regan, Alexander Rosenberg, and Hal Varian, and from later correspondence with Varian.

recommend the cessation of all such transactions. To see it as an "all or nothing" question is to miss the point of the criticism altogether. It is a question of "how much," "how unrestrained," "how supplemented." Even the most ferocious critic of the market mechanism is unlikely to be looking for a world in which every person must produce every bit of the goods and services that he or she can consume. The question must be posed differently.

A third problem comes from a different direction. Insofar as the market mechanism is valued as an instrument, its moral value must ultimately derive from somewhere else. We cannot begin to assess the moral standing of the market mechanism without first asking, "To what intrinsically valuable things is the market mechanism instrumental?" We have to place the role of markets in a fuller moral context.

I shall take up the question of instrumentality in the next section, and then go on to the problem of integration.

The Consequent Good or the Antecedent Freedom?

Most defenses of the market are instrumental in terms of the goodness of the *results* achieved. It works "efficiently"; it serves our "interests"; it is "mutually beneficial"; it delivers "the goods"; it contributes to "utility"; it serves as the "invisible hand" by which man is led to promote an end which was no part of his intention.[1] On this view, the market is good because its results are. For example, Friedman and Friedman argue: "on the whole, market competition, when it is permitted to work, protects the consumer better than do alternative government mechanisms that have been increasingly superimposed on the market."[2] We need, of course, a criterion for judging the interests of the consumers and the relevance of these interests to the overall moral assessment of the market. We also need some methodology for interpreting the exact content of the Friedmans' claim before it can be

[1] The last phrase comes from Adam Smith, *The Wealth of Nations* (1776). Aside from indicating wherein the virtue of the market mechanism lies, it points to the fact that no individual participant in the process aims at *all* the results the market achieves. Friedrich von Hayek has seen in this a great new insight – indeed a great theory of "the result of human action but not of human design" – initiated allegedly by Adam Smith, "revived" by Carl Menger, and now enshrined by Hayek; see his *Studies in Philosophy, Politics, and Economics* (Chicago: University of Chicago Press, 1967), pp. 96–105. One has to be careful about what is being asserted here. It would be wrong to say that no one aims at *any* of the results achieved. In this model, each person is assumed to pursue, as far as is feasible, his own interest, and this pursuit is *fulfilled* by the market transaction. "The butcher, the brewer, or the baker" did not aim at "our dinner," but *we* presumably *did*. The fact that not *all* the results, nor the *pattern* of the results, was anyone's "design" seems to be an unremarkable fact. Surely, Adam Smith's main contribution, in this area of analysis, was to show how the results of different people's "designs" are *coordinated and achieved* by the market. I have discussed this question, among other issues, in "The Profit Motive," *Lloyds Bank Review*, vol. 147 (1983).

[2] Milton and Rose Friedman, *Free to Choose* (London: Secker and Warburg, 1980), p. 222.

properly assessed. But there can be little doubt that this approach to the value of the market mechanism – whatever its exact content and force – rests on assessing *results*.

Perhaps less obvious – but obvious enough – so is the claim that the market makes people "free to choose," a freedom that might be seen to be valuable in itself (whether or not it also helps in other ways, such as the protection of the interests of the consumers). The goal of "freedom to choose" provides an alternative (though not unrelated) basis for the assessment of markets by its results. "That is the basic difference between the market and a political agency. You are free to choose. There is no policeman to take the money out of your pocket to pay for something you do not want or to make you do something you do not want to do."[3] Whether the freedom to choose is *itself* a fundamental value – not only instrumentally so at some "higher level" of analysis – is a difficult question that need not be addressed in the present context.[4] The importance of the market, on this "free to choose" view, derives from the *more basic* value of that freedom (no matter how the value of that freedom is itself obtained).

But there is also a different possibility that must be considered. It could be the case that what is at issue is not the value of the freedom to choose. People may be seen as having fundamental "rights," and the exercise of those rights may be seen as not requiring any justification at all. If the market is seen as being part and parcel of the exercise of such rights, then markets may be defended on the basis of antecedent rights, rather than in terms of the results, including freedom of choice, that they may achieve. To assert that "individuals have rights, and there are things no person or group may do to them (without violating their rights)"[5] would *imply* the freedom to make market transactions (given the way the rights referred to are characterized). The question of the consequences, in this procedure, arises later, *after* the right to transact (and thus to engage in market relations, in the broad sense) has already been given a stable moral status.

In this formulation, rights specify rules – of ownership, transfer, etc. – that have to be followed for making a person's actual "holdings" legitimate. The results of these rules are accepted precisely because they have resulted from following the right rules, not because the results judged as *outcomes* are in themselves good. The results (including serving the interests of consumers, or even enjoying the "freedom to choose") may or may not, in fact, be judged to be good *as results*. But whatever the conclusion of that outcome analysis

[3] *ibid.*, p. 223.

[4] See R. M. Hare, *Moral Thinking: Its Levels, Methods and Point* (Oxford: Clarendon Press, 1981), on "levels" of moral thinking, and on the distinction between the "intuitive" and the "critical." See also John Gray, *Mill on Liberty: A Defence* (London: Routledge, 1983).

[5] Robert Nozick, *Anarchy, State and Utopia* (Oxford: Blackwell, 1974), p. 1.

might be, the justification of the market, in this aproach, is not based on the merits of the results. Indeed, it is apparent that there are consistency problems in an attempt to combine this approach with another that justifies actions (including, of course, transactions) in terms of preferring one "pattern" of outcomes over another, since that would "over-determine" the system.[6]

If this rights-based "procedural" view is accepted, then the traditional assessment of the merits and demerits of the market, in terms of the goodness of outcomes, would be quite misplaced. The moral necessity of having markets would follow from the status of rights and not from the efficiency or optimality of market outcomes. This approach, incidentally, involves the rejection of the way economists – the professional group most immediately concerned with the assessment of the role of markets – have typically examined the case for and against the market. In the economist's picture of "social welfare," rights are seen as purely institutional (typically legal) artifacts, without any importance of their own: rights are judged – in the typical welfare economic framework – in terms of how they fulfill or thwart people's interests.

The failure to consider the "procedural" approach at all is certainly an omission that deserves some comment. Robert Nozick's analysis represents one example of nonconsequentialist moral reasoning, and this type of reasoning must be seriously considered by welfare economists. Even if such reasoning is ultimately rejected, there is no question that that approach deserves the most serious consideration.

It is also worth noting in this context that the force of a rights-based procedural justification of market operations is independent of our understanding of empirical regularities in the real world, in a way that any consequentialist justification for market operations cannot be. For example, one could have a lively debate as to whether Friedman and Friedman are right about what they say on the relative merits of the market mechanism in safeguarding the interest of consumers, or whether, in fact, it is the case that "the freedom to choose" in any substantive sense is better guaranteed by the market mechanism than by some feasible alternative. If it is shown that the empirical relationships on which the consequentialist justifications depend are erroneous, then the case for the market mechanism, derived from such reasoning, would collapse.

The same applies to a moral assessment of the market based on the

[6] Robert Nozick does point to (what he calls) "invisible-hand explanations" of the emergence of social institutions (such as markets), quoting Adam Smith (*ibid.*, p. 18). But, consistently with his own approach, he does not proceed to assess such institutions in terms of the goodness of interest-fulfilling outcomes.

"freedom" resulting from it. If that freedom is shown to be "illusory,"[7] then the case for the market mechanism would be dis-established. That assessment would have to be thoroughly dependent on the truth of the causal hypotheses linking markets and the resulting freedom. Questions can be raised on the empirical acceptability of the presumed causal connection.

In contrast, one interesting feature of the *a priori* rights-based justification of market operations is that it is not contingent on the empirical regularities that hold in the real world. The results of market transactions may be good, but even if they are bad or unassessable, they are still legitimate because they are sanctioned by antecedent rights. This can be seen as giving the nonconsequentialist approach a "robustness" that the consequentialist approach lacks, especially since empirical regularities are hard to establish, and predictive theories in this field can be extremely flimsy.

On the other hand, this "robustness" and the immunity from empirical critiques are also plausible sources of skepticism about that ethical structure. Why must we accept the priority of these rights?[8] Do the rights of ownership and exchange have "foundational" status? Must we really accept the notion that some arrangements required by the recognition of these rights are morally acceptable irrespective of their consequences – however bad they might be? What if the consequences are totally disastrous?

The last is not only a matter of purely theoretical speculation. As I have tried to argue elsewhere,[9] many large famines – in which millions of people have perished from hunger and hunger-related diseases – have taken place (even in the recent past) without any overall decline in food availability at all, with no "natural cause" making the famines inescapable. People have been deprived of food precisely because of sudden and violent shifts in "entitlements," resulting from the exercise of rights that people "legitimately" have within the given legal system. Loss of employment and wage income have often led to starvation. Changes of relative prices have

[7] See, for example, the different analyses of this issue by Z. Husami, "Marx on Distributive Justice," *Philosophy and Public Affairs*, vol. 7 (1978); H. Steiner, "Individual Liberty," *Proceedings of the Aristotelian Society*, vol. 74 (1974); G. A. Cohen, "Capitalism, Freedom and the Proletariat," A. Ryan, ed., *The Idea of Freedom: Essays in Honour of Isaiah Berlin* (Oxford: Clarendon Press, 1979); G. A. Cohen, "Illusions about Private Property and Freedom," J. Mepham and D. Rubens, eds., *Issues in Marxist Philosophy* (Hassocks: Harvester Press, 1981); O. O'Neill, "The Most Extensive Liberty," *Proceedings of the Aristotelian Society*, vol. 79 (1979–80); and others. See also Gerald Dworkin, *et al.*, *Markets and Morals* (Washington: Hemisphere Publishing, 1977).

[8] Allan Gibbard, "Natural Property Rights," *Nous*, vol. 10 (1976). Gibbard examines the possible claim of "property rights" to be "grounded in principles of natural liberty," with or without John Locke's [John Locke, *The Second Treatise of Government* (1764)] qualification regarding the libertarian position, and shows why the claim is hard to justify.

[9] Amartya Sen, *Poverty and Famines: An Essay on Entitlement and Deprivation* (Oxford: Clarendon Press, and New York: Oxford University Press, 1981).

sometimes driven the losers to the wall. The legal systems in question differ, of course, from an *idealized* legal structure of the kind required by a theory of rights of the type we are examining, but, nevertheless, in many respects they have a good deal of similarity. In fact, it is easy to show that, with a system of rights justified independently of consequences, it is possible to have disasters of this kind occurring without anyone violating anyone else's rights at all. The contingency of ownership, as well as influences that determine transfers and terms of trade, can easily lead a particular occupation group into absolute deprivation, destitution, and decimation, without anything illegitimate and perverse having happened from a rights' perspective.

It is not irrelevant to ask the question: If such starvation and famine were to occur, must the results of the market operation be taken as "acceptable," simply because they have followed from people legitimately exercising the rights they have? It is not easy to understand why rules of ownership, transfer, etc., should have such absolute priority over the life and death of millions of people.

In response to this it can, of course, be claimed that only in these extreme cases will it be right to override the requirements imposed by rights and their legitimate exercise. There could be a caveat that nullifies rights in these cases, but not in others.[10]

Robert Nozick himself keeps the question open as to whether "catastrophic moral horrors" should provide a ground for violating rights. There *is* a dilemma here. If disastrous consequences can be used as a ground for nullifying deep-seated rights, surely that completely undermines the consequence-independent way of looking at rights. If disastrous consequences would be adequate to nullify any rights (even the most important ones), perhaps bad-but-not-so-disastrous consequences would be adequate to nullify other, less central, rights? Some of the rights related to the ownership and use of property may well be seen to be less "deep-seated" than some other rights, e.g., the personal-liberty rights with which civil libertarians have been, understandably, most concerned. Once rejection, based on consequential evaluation, is admitted into the picture of moral reckoning, it is difficult to find an obvious stopping place for a theory of rights that is based on a purely procedural approach.

[10] Contrast the model of "alienable rights" in A. Gibbard, "A Pareto-Consistent Libertarian Claim," *Journal of Economic Theory*, vol. 7 (1974), in which rights have extreme sensitivity to the nature of the outcome. It is arguable that such a system of outcome sensitivity may not do full justice to the procedural nature of rights, but on the other hand it is very hard to see why rights should continue to be not alienable at all even when the results of the exercise of rights are plainly terrible. Some connections between outcomes and rights are discussed in my "Rights and Agency," *Philosophy and Public Affairs*, vol. 11 (1982). See also D. H. Regan, "Against Evaluator Relativity: A Response to Sen," *Philosophy and Public Affairs*, vol. 12 (1983); and Amartya Sen, "Liberty and Social Choice," *Journal of Philosophy*, vol. 80 (1983).

It is hard to argue that the value of the market can be divorced from the value of its results and achievements. This is not to say that the assessment of market operations, or the evaluation of the market mechanism, must be based only on *utility* consequences (defined in terms of satisfaction, desire-fulfillment, etc.). For example, it is quite possible to take into account what the market mechanism in general, and specific market operations in particular, would do to such things as the freedom of the individuals in society. If being "free to choose" is regarded as an important part of a person's well-being (*or* regarded as morally important despite its not being a part of personal well-being), it would be perfectly sensible to include this in the assessment of the consequences of market operations. This would obviously be inadequate for producing a procedural moral system of the kind that Robert Nozick and others have tried to develop. But by taking freedom into account in our calculation of consequences, the force of their criticism of narrow consequential systems can be partly accommodated.

I have, in fact, tried to argue elsewhere that taking note of the fulfillment or violation of rights, and of the realization or nonrealization of freedom, in the assessment of social arrangements, does more justice to the *importance* of rights and freedoms than a purely constraint-based (e.g., Nozickian) system of rights and freedom can do.[11] This is not, as is often assumed, only a matter of the contrast between "negative" and "positive" freedom. Even if one ignores altogether "positive" freedom, and confines one's attention to assessing "negative" freedom, there is still a strong case for including the badness of violation of negative freedom in evaluating consequent states. Given imperfect compliance, the violation of negative freedom of A by B can sensibly figure in C's calculation regarding what to do, and a consequence-sensitive system can deal with such links. It is inadequate to try to deal with negative freedom through constraints only, since they have no relevance to C's calculations if it is B who violates A's negative freedom, even if C could have helped to stop this violation.

It could be argued that the consequential way of taking note of rights may not be able to pay adequate attention to the "deontological" aspects of agent-relative action assessment. This might be thought to be particularly so for the special role of "negative" freedom. To this point some responses may be made, which I shall note here without elaboration or development. First, this is really a separate matter requiring *additional* structure,[12] and the correct starting point for "deontological" issues may not be rights at all, but some notion of duty linked with the position-relativity (in

[11] Amartya Sen, "Rights and Agency".

[12] See my "Evaluator Relativity and Consequential Evaluation," *Philosophy and Public Affairs*, vol. 12 (1983), and "Well-being, Agency and Freedom: The Dewey Lectures 1984," *Journal of Philosophy*, vol. 82 (1985).

particular, "doer relativity") of moral evaluation.[13] Second, such additional structure for personal morals may be quite consistent with a result-oriented assessment of institutions such as markets and property.

No matter how that additional deontological question is dealt with, the *valuation* of freedom – even of "negative" freedom – would demand a more consequence-sensitive approach, not reliant only on imposing constraints. Those who have argued that the traditional consequentialist approaches – most notably the utilitarian systems – take inadequate note of the importance of freedom, have not been, in my view, mistaken in this claim. But the failure arises not so much from the concentration on consequences, but from the way consequences are assessed. If utilitarianism is split into three distinct parts,[14] viz., "welfarism" (judging states of affairs only by utility information), "sum-ranking" (dealing with utility information by simply adding them), and "consequentialism" (judging actions, rules, etc., ultimately by the goodness of the states of affairs resulting from them), then the primary failing, it can be argued, arises from "welfarism."

This is, of course, a more general question, and one which we need not really take up in this paper. If it is accepted that the moral importance of the market mechanism and market operations has to be seen primarily in terms of its results, then the need to go more deeply into consequential systems has to be recognized. The value of the market instrument is, then, consequential, derivative, and contingent. To assess that value we have to understand the more fundamental social values of well-being, freedom, and justice.[15] We have to examine also the causal links between the institutional arrangements and the realization of the more fundamental values.

[13] One way of seeing the problem of personal morality in this type of context is in terms of a system of action evaluation that is consequence-sensitive, but not fully "consequentialist." Another way of dealing with it is to make the evaluation of states of affairs *position-relative* to the person doing the evaluation (including his or her own agency). There is, in fact, a case for such position-relativity on grounds of ethical cogency; or at least so I have tried to argue in "Rights and Agency"; see also the exchange between Donald Regan, "Against Evaluator Relativity," and A. K. Sen, "Evaluator Relativity and Consequential Evaluation," *Philosophy and Public Affairs*, vol. 12 (1983).

[14] Discussed in Amartya Sen, "Utilitarianism and Welfarism," *Journal of Philosophy*, vol. 76 (1979).

[15] On questions as to how these moral values may be interpreted, assessed and integrated, there are – not surprisingly – enormous differences; see for example K. J. Arrow, *Social Choice and Individual Values* (New York: Wiley, 1951); J. C. Harsanyi, "Cardinal Welfare, Individualistic Ethics, and Interpersonal Comparisons of Utility," *Journal of Political Economy*, vol. 63 (1955); and *Essays on Ethics, Social Behaviour and Scientific Explanation* (Dordrecht: Reidel, 1976); I. M. D. Little, *A Critique of Welfare Economics* (Oxford: Clarendon Press, 2nd edition, 1957); J. M. Buchanan and G. Tullock, *The Calculus of Consent* (Ann Arbor, MI: University of Michigan Press, 1962); J. Rawls, *A Theory of Justice* (Cambridge, MA: Harvard University Press, 1971); and "Kantian Constructivism in Moral Theory: The Dewey Lectures 1980," *Journal of Philosophy*, vol. 77 (1980); R. Dworkin, *Taking Rights Seriously* (London: Duckworth, 1977); and "What is Equality," *Philosophy and Public Affairs*, vol. 10 (1981). On

Optimality and Inequality

The assessment of the market mechanism in welfare economics has tended to rely – at least in recent decades – on the so-called "basic theorem of welfare economics."[16] Indeed, in the theory of welfare economics, the main rationale of the market mechanism has been typically viewed in the light of the dual relationship captured by this theorem.[17]

The first part of this "basic theorem," asserting that every competitive equilibrium is a Pareto optimum, has been called the "direct theorem." The other part, claiming that every Pareto optimum is a competitive equilibrium, may be called the "converse theorem." Both theorems are established by making a set of restrictive assumptions. The assumptions are not exactly the same in the two cases, but they have several requirements in common (e.g., the absence of externalities[18]).

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related matters, see also H. Varian, "Distributive Justice, Welfare Economics and The Theory of Fairness," *Philosophy and Public Affairs*, vol. 4 (1975); G. Dworkin, et al, *Markets and Morals*; G. Calabresi and P. Bobbitt, *Tragic Choices* (New York: Norton, 1978); D. Usher, *The Economic Prerequisites to Democracy* (New York: Columbia University Press, 1981); J. Roemer, *A General Theory of Exploitation and Class* (Cambridge, MA: Harvard University Press, 1982); and "Equality of Talent," Working Paper 239, Economics Department, University of California, Davis, (1984); B. C. Frey, *Democratic Economic Policy* (Oxford: Martin Robertson, 1983); A. M. McLeod, "Justice and the Market," *Canadian Journal of Philosophy*, vol. 13 (1983); P. K. Pattanaik and M. Salles, *Social Choice and Welfare* (Amsterdam: North-Holland, 1983). I have tried to discuss some of these issues in Amartya Sen, *Collective Choice and Social Welfare* (San Francisco: Holden-Day, 1970; republished, Amsterdam: North-Holland, 1979); "Equality of What?" in S. McMurrin, ed., *Tanner Lectures on Human Values*, vol. 1 (Cambridge: Cambridge University Press, 1980, reprinted in my *Choice, Welfare and Measurement* (Oxford: Blackwell; and Cambridge, MA: M.I.T. Press, 1982); "Rights and Agency," *Philosophy and Public Affairs*; "Well-being, Agency and Freedom: The Dewey Lectures 1984."

[16] K. J. Arrow, "An Extension of the Basic Theorems of Classical Welfare Economics," in J. Neyman, ed., *Proceedings of the Second Berkeley Symposium on Mathematical Statistics and Probability* (Berkeley, CA: University of California Press, 1951); G. Debreu, *Theory of Value* (New York: Wiley, 1959); K. J. Arrow and F. H. Hahn, *General Competitive Analysis* (San Francisco: Holden-Day, 1971; republished, Amsterdam: North-Holland, 1979).

[17] As Dorfman, Samuelson and Solow put it: "More recently it has become common to sum up all these in one brief and easily understood theorem which comprises everything of significance and provides the backbone of welfare economics. This fundamental theorem states 'every competitive equilbrium is a Pareto optimum; and every Pareto optimum is a competitive equilibrium.'" R. Dorfman, P. Samuelson, and R. Solow, *Linear Programming and Economic Analysis* (New York: McGraw-Hill, 1958), pp. 409–410.

[18] This assumption is not in fact fully needed for each of the results; see S. Winter, "A Simple Remark on the Second Optimality Theorem of Welfare Economics," *Journal of Economic Theory*, vol. 1 (1969); and G. C. Archibald and D. Donaldson, "Non-paternalism and the Basic Theorems of Welfare Economics," *Canadian Journal of Economics*, vol. 9 (1976). These further results indicate the presence of an asymmetry, in the required assumptions regarding "externalities," between the direct theorem and the converse theorem. Some other properties (e.g., convexity) have very disparate relevance, indeed, to the two theorems (the direct theorem does not require any convexity assumption, whereas the convex theorem certainly requires it in some form or other).

The ethical force of the direct theorem in establishing the case for the market mechanism may be seen to be quite limited. A Pareto optimum does, of course, have the valuable property that not all the parties can be made better-off (in terms of utility) in any alternative feasible state. But it is easily seen that a situation can be Pareto optimal but nevertheless highly objectionable – indeed, possibly disastrous. If the utility of the deprived cannot be raised without cutting into the utility of the rich, the situation can be Pareto optimal but truly awful.

There are two standard responses to this criticism of the relevance of the direct theorem. One is to argue that the criticism is based on making explicit or implicit use of "egalitarian" values, and many people would dispute whether such values have force. I have tried to address that issue elsewhere,[19] and this is perhaps not the occasion to go again into that old question. I shall have a little more to say on this in the next section, but for the moment I simply assert that indifference to the inequality of well-being requires some justification. The fact that equality is widely valued does not, of course, establish its validity. But it does demand a response, and a presumption of this kind calls for some serious argument as to why, in this case, inequality is acceptable. If the direct theorem is to be treated as one of great ethical significance, we must be told more about the *general moral irrelevance* of inequality of well-being, *or* of the moral case for the *particular* inequalities that would contingently occur *in each case.*

The other counterargument suggests that we should shift our attention from the "direct theorem" to the "converse theorem." Given "welfarism," i.e., assuming that "social welfare" is a function of utility information only (and this seems to be the common assumption in welfare economics), it is plausible to argue that the best of the feasible social states must be *at least* Pareto optimal. Since, according to the "converse theorem," *every* Pareto-optimal feasible state is a perfectly competitive equlibrium, with respect to some set of prices (and some initial distribution of resources), it follows that it is invariably "possible" to achieve the very best through some market mechanism (provided the market is perfectly competitive). The fact that some particular Pareto-optimal states may be morally revolting does not affect this argument one iota, since we could have chosen another – better – Pareto optimum (not this awful one) by having a different initial distribution of resources, and by relying on the perfectly competitive mechanism to take us to the appropriate social optimum. Not surprisingly, Debreu describes the converse theorem as a "deeper" result, and Koopmans notes that it is the

[19] Amartya Sen, *On Economic Inequality* (Oxford: Clarendon Press; and New York: Norton, 1973).

converse theorem, rather than the direct theorem, which is "the central proposition of the 'new welfare economics'."[20]

The converse theorem is undoubtedly a major theorem in the literature of resources allocation. But to use it as a justification for the market mechanism requires further argumentation. The converse theorem points to the possibility that, if we get the initial distribution of resources right, we can reach the very best state of affairs through the competitive market mechanism *without requiring any political interference with the market mechanism.* That can certainly be seen as a conditional rejection of the necessity of a political mechanism.

On the other hand, *how* do we get the appropriate initial distribution of resources? The need for the redistribution of ownership is, of course, one of the central political issues that divides the "right" from the "left." Classical socialist arguments have been concerned primarily with the ownership of "means of production," and only secondarily with such questions as "externalities" and other "vices" with which the market mechanism cannot allegedly cope. If the real case for the market mechanism – through the highroad of the "converse theorem" – is dependent on a major revolution in the distribution of resource ownership, then the case for *laissez-faire* and for using the allegedly "non-political" route of the market mechanism is thoroughly undermined. The "converse theorem" belongs to the "revolutionist's handbook."

There is, in fact, a further difficulty, and this concerns the issue of incentives. Once the initial distribution is appropriate to the optimal outcome, the perfectly competitive outcome, if unique and globally stable,[21] will take us in the direction of the very best state of affairs. However, in order to determine the *appropriate* initial distribution of resources (for optimality in terms of the values usually invoked in traditional welfare economics, including "equity"), one would need a great deal of information about each person's productivity, tastes, etc. It will not be in the interest of those who are likely to lose out in the process of redistribution to reveal these facts. The incentive to reveal information is absent in such a system, under the standard assumption of self-interested behavior.[22]

[20] G. Debreu, *Theory of Value*; T. C. Koopmans, *Three Essays on the State of Economic Science* (New York: McGraw-Hill, 1957), p. 27.

[21] Uniqueness and global stability, incidentally, are additional assumptions and no mean demands either. See Arrow and Hahn, *General Competitive Analysis*.

[22] This problem of the incentive to reveal information has to be distinguished from the problem of informational economy, to which the precedures for "decentralized resource allocation" are addressed (see, for example, E. Malinvaud, "Decentralized Procedures for Planning," in E. Malinvaud and M. O. L. Bacharach, eds., *Activity Analysis in the Theory of Growth and Planning* (London: Macmillan, 1967); G. M. Heal, *The Theory of Economic Planning*

It would, thus, appear that while the converse theorem is intellectually much more attractive, it is not easy to translate it into a practical case for the market mechanism.[23] If the *information* regarding individuals is inadequate for determining what the initial distribution of resources should be, *or* if there is an absence of – or reluctance to use – a political mechanism that would *actually* redistribute resource-ownership and endowments appropriately, then the practical relevance of the converse theorem is severely limited. On the other hand, the direct theorem continues to apply without these qualifications (provided the other assumptions, such as the absence of externalities of particular kinds can be legitimately made.)[24] Indeed, for the "non-omniscient," or the "non-revolutionary," government, it is the direct theorem rather than the converse theorem that is of immediate interest in judging the market mechanism.

This, of course, does bring us back to the earlier question as to how good an outcome we might regard a Pareto optimum to be. If one is concerned about income distribution, or about inequalities of utility or well-being, it is

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(Amsterdam: Horth-Holland, 1973); M. Weitzman, "Prices versus Quantities," *Review of Economic Studies*, vol. 41 (1974); P. Dagsputa, *The Control of Resources* (Oxford: Blackwell, 1982). In such "decentralized" procedures, each agent acts as a member of a "team," and it is typically assumed that they have *shared objectives*, though disparate access to information. The problem of decentralized resource allocation, when the agents have their own respective goals, which may conflict, has not been much studied in the literature, and will certainly not lead to simple and comforting results.

[23] There are various "incentive compatible" mechanisms (see, for examples, T. Groves and J. Ledyard, "Optimal Allocation of Public Goods: A Solution to the 'Free Rider' Problem," *Econometrica*, vol. 45 (1977); J. Green and J.-J. Laffont, "Characterization of Satisfactory Mechanisms for the Revelation of Preferences for Public Goods," *Econometrica*, vol. 45 (1977); P. Dagsputa, P. Hammond, and E. Maskin, "The Implementation of Social Choice Rules: Some General Results in Incentive Compatibility," *Review of Economic Studies*, vol. 46 (1979); which deal effectively with the problem of "the free rider" in terms of the incentive to *do* the right thing, *given* the initial distribution of resources, despite the presence of such problems as "public goods." These "solutions" are not, however, addressed to the problem of how to deal with the incentive to reveal information of a kind that would permit the policy makers to make judgments about the right initial distribution of resources (in line with the distributional objectives of policy making). Nor do they address the problem of revelation of individual *judgments* to be combined in an "aggregate" judgment (e.g., to decide on equity). On the last, see A. Gibbard, "Manipulation of Voting Schemes: A General Result," *Econometrica*, vol. 41 (1973); M. A. Satterthwaite, "Strategy-Proofness and Arrow's Conditions: Existence and Correspondence Theorems for Voting Procedures and Social Welfare Functions," *Journal of Economic Theory*, vol. 10 (1975); P. K. Pattanaik, *Strategy and Group Choice* (Amsterdam: North-Holland, 1978); J.-J. Laffont, ed., *Aggregation and Revelation of Preferences* (Amsterdam: North-Holland, 1979); H. Moulin, *The Strategy of Social Choice* (Amsterdam: North-Holland, 1983); B. Peleg, *Game Theoretic Analysis of Voting in Committees* (Cambridge: Cambridge University Press, 1984).

[24] In fact, insofar as we value the market achievement not in terms of Pareto-optimality (i.e., reaching an "undominated" vector of utilities), but in terms of the corresponding notion of being "free to choose" (i.e., having an "undominated" n-tuple of individual freedoms to pursue *whatever* they decide to seek), the assumption of self-interested behavior can be also significantly relaxed.

very hard to settle just for "any Pareto-optimal state," without looking further.

This particular difficulty brings out an extraordinary aspect of the market mechanism that is often overlooked. It is that the specification of the market mechanism is an essentially *incomplete* specification of a social arrangement. Even with the purest, perfectly competitive market mechanism, we are not in a position to understand precisely what will happen until we know something more about the rest of the social arrangement, in particular the distribution of endowments and resource ownership. It is an extraordinarily ambitious program to judge one part of the social arrangement (the market mechanism) without assuming something specific about the other parts. It is not surprising, therefore, that our view of the market mechanism may well be thoroughly dependent on how the incomplete description of the social arrangement given by the market mechanism is completed by other substantive descriptions. For any moral approach that responds positively to equality of one kind or another (of well-being, or of resources[25]), the assessment of the market mechanism must be integrally related to the rest of the picture.[26]

I ought to mention, in this context, that there are a number of other "results" that are often cited in the literature dealing with the moral case for the market mechanism based on achievement assessment. For example, in dealing with the *effects* of property rights, reference is often made to Ronald Coase's theorem[27] – that the optimality of the outcome is independent of the initial distribution of property rights, provided certain assumptions (such as absence of transactions costs) are made. However, the result depends upon a very weak definition of "optimality," and the difficult issues discussed in the last few paragraphs are essentially not addressed.[28]

The only way of dealing with the problem of inequality in the outcome of market mechanism is to face that issue directly, rather than avoiding it, either

[25] See R. Dworkin, "What is Equality." See also J. Roemer, "Equality of Talent"; and H. Varian, "Dworkin on Equality of Resources," mimeographed, University of Michigan, Ann Arbor (1984).

[26] There can, however, be useful *partial* criteria of judging achievements, e.g., whether the mechanism satisfies specific requirements of "horizontal equity" or "symmetry preservation." The market mechanism can be partially defended from these particular perspectives. See, for example, D. Schmeidler and K. Vind, "Fair Net Trade," *Econometrica*, vol. 40 (1972); H. Varian, "Equity, Envy and Efficiency," *Journal of Economic Theory*, vol. 9 (1974).

[27] R. H. Coase, "The Problem of Social Cost," *Journal of Law and Economics*, vol. 3 (1960).

[28] For different interpretations of what Coase's line of reasoning achieves, see J. M. Buchanan, *Freedom in Constitutional Contract* (College Station: Texas A & M University, 1977); and "Rights, Efficiency and Exchange: The Irrelevance of Transactions Cost," mimeographed, Center for Study of Public Choice, George Mason University (1983); G. Calabresi and P. Bobbit, *Tragic Choices*; R. Cooter, "The Cost of Coase," *Journal of Legal Studies*, vol. 11 (1982); E. J. Green, "Equilibrium and Efficiency under Pure Entitlement Systems," in A. H. Meltzer and T. Romer, eds., *Proceedings of the Conference on Political Economy*, vol. 2, Supplement to *Public Choice* (1982).

by silence, or by some peculiar definition of "optimality." It might be the case that inequality of well-being or of resources is of no moral concern, but if so, that position has to be made and defended. It becomes, of course, particularly hard to defend that proposition when inequalities are so great that some people live in extreme misery, or indeed die of starvation or hunger. But even otherwise the question is far too important to be neglected.

The Producers' Rights to the Product

One other line of moral defense of the market mechanism (traced to different "foundational" values) raises the question of who is "producing" what, and argues for the right of the producer to enjoy the fruits. On this view, inequalities in the outcome are of no concern, unless they are out of line with the productive contributions made by the different individuals. This approach does directly address the issue of inequality, suggesting a method of dealing with it which is based on *the right of the producer* rather than on *the right of the needy*. I examine that approach next, by scrutinizing a powerful exposition of it by P. T. Bauer.[29]

Bauer's attack on "the unholy grail of economic equality" has several features, but it includes *inter alia* what I have elsewhere called "the personal production view."[30] This issue is quite central to the moral assessment of the market mechanism. Bauer argues that "economic differences are largely the result of people's varied capacities and motivations." (p. 19) Given this interpretation of economic differences, he sees little that is wrong with such inequality: ". . . it is by no means obvious why it should be unjust that those who produce more should enjoy higher income." (p. 17)

Bauer argues that the high income of "the relatively prosperous or the owners of property" are "normally . . . *produced* by their recipients and the resources they own." (p. 12, emphasis added) Given this "personal production view" of inequality, the moral assertion of the appropriateness of such an inequality can be seen as a variant of an "entitlement" argument. However, the entitlement reasoning here does not take the procedural form it takes in the system of Nozick and others, since the rights that people have, on Bauer's view, are not that of ownership, transfer, etc., but of actually getting what one has "produced." Bauer is concerned with results and not just with procedural rules of contract, etc.

In this respect, the entitlement reasoning of Bauer relates to a labor-entitlement system of the kind that one interpretation of the Marxian theory

[29] P. T. Bauer, *Equality, The Third World and Economic Delusion* (Cambridge, MA: Harvard University Press, 1981).

[30] See Amartya Sen, "Just Desert," *New York Review of Books*, vol. 19 (March 4, 1982). See also P. T. Bauer's rejoinder in the same journal, June 10, 1982; also P. T. Bauer, *Reality and Rhetoric: Studies in the Economics of Development* (London: Weidenfeld, 1984).

of "exploitation" leads to. According to that view, labor "produces" all the value of the output (or "nature" and labor do, with no "residual" left), and the entitlement of labor to get the output is related to the fact. Any "shortfall" reflects "exploitation."[31] In Bauer's system, the output is produced not only (nor, in any Lockean sense, "ultimately") by labor, but by the different factors of production (including capital). And the marginal productivity theory is given an interpretation of real contribution, as opposed to having only allocational usefulness in terms of counterfactual calculations.

It is not at all implausible to think that "the personal production view," if correct, can lead to some case for inequality, even though it would still have to compete with claims arising from other considerations, such as that of needs. If, for example, a person has himself produced – unaided by others – some food, and another person wants to snatch that food away from the first, then the case for the first person rather than the second having that food might well be seen to be strong. While this judgment may be countered with competing arguments for a different distribution (the stronger need of the second person, if that is the case), there is undoubtedly some plausibility in arguing that the fact that the first person has produced the good in question *is* a matter of moral relevance. Also, if there are no strong contrary arguments, i.e., if the second person's needs are not noticeably different from those of the first, the case for the first having the food on grounds of having "produced" it would seem to be quite strong, at least in terms of common-sense morality.

"The personal production view" is, however, rather difficult to sustain. If production is an interdependent process, involving the joint use of different resources, it is not generally possible to separate out which resource has produced how much of the total output. There is no obvious way of determining that "this part" of the output is due to resource 1, and "that part" due to resource 2, etc. The method of attribution according to "the marginal product" concentrates on the extra output that one incremental unit of the resource would produce, *given* the amounts of the other resources. This method of accounting can lead to problems of internal consistency, except under some special assumptions (in particular, constant returns to scale). But even if these assumptions are made, the relevance of the accounting to "the personal production view" is deeply problematic.

[31] There are, of course, a great many difficulties in this way of seeing the Marxian system, as many contributions by Marxian economists have brought out. There is, in fact, a strong case for seeing the relevance of Marxian exploitation theory from a perspective different from that of production entitlement. On these issues, see M. Morishima, *Marx's Economics* (Cambridge: Cambridge University Press, 1973); I. Steedman, *Marx after Sraffa* (London: NLB, 1977); G. A. Cohen, *Karl Marx's Theory of History* (Oxford: Clarendon Press, 1978); J. Elster, "Exploitation and the Theory of Justice," mimeographed, Historisk Institute, University of Oslo (1980); J. Roemer, *A General Theory of Exploitation and Class*.

In fact, the marginalist calculus is not concerned with finding out who "actually" produced what. Marginal accounting, when consistent, has an important function in decision making regarding the use of resources, suggesting when it would be appropriate to apply an additional unit of resource, and when it would not. To read in that counter-factual marginal story one of "actual production" – who in fact produced what part of the total output – is to take the marginal calculus well beyond its logical limits.

For example, if it turns out that, using the marginalist calculus to evaluate factor contributions, yields the result that 40 percent of the output is due to labor, 40 percent due to machinery, and 20 percent due to management, that just tells us something about the respective relative values of the marginal contributions multiplied by the total amounts of the respective resources. It would not, of course, follow that any of these three factors of production could produce their respective shares unaided by the others. Indeed, the apportioning is not even one that is done by adding together the marginal contributions of all the respective units one after another, but rather goes by weighting the *entire* amount of the resource input by the marginal valuation of the counterfactual additional contribution of that resource *at the point of equilibrium*. Under the competitive distributive process, that is what will determine the relative shares of income, and in this sense, it has predictive value as well as allocational use. But "the personal production view" adds to this real use a spurious interpretation as to who has "produced" what. This comes, as it were, from nowhere, and it is essentially a fiction. It might, of course, be seen as a "convenient fiction," but that fiction is a whole lot more convenient for some than for others.

The problem becomes even more complicated when the comparison extends to incomes generated from the production of *different* goods, since the relative incomes would then depend on the relative prices of these products, introducing an additional element of arbitrariness into "the personal production view." The significance of the relative prices in terms of "productive contributions" would require a further fiction in translating the "marginal rates of transformation" – again, a set of counterfactual magnitudes – into a set of actual production weights.

There is the further problem that "the personal production view" applies only to resources, and to move from there to the contribution of the person *owning* the resources is a considerable jump. The right of the owners of productive resources to receive high income requires some justification of the moral relevance of ownership. It is not justified on the simple ground, to which Bauer refers, of the income-rights of "those *who* are more productive and contribute more to output." (p. 11; emphasis added) Once again, the traditional socialist literature has not been so concerned with disputing the productive contribution of different resources as it has been with disputing

the right of the *owners* of productive resources to grab what the resources produce.

If this reasoning is correct, the problem of inequality raised in the context of the other defenses of the market mechanism is not disposed of by moving to "the personal production view." This is not because there is no intuitive appeal whatever to the idea that one ought to have a right to something one has produced "oneself." But (1) in a world of interdependent production, that condition is difficult to apply to resources; and (2) in a world of nonpersonal resources, it is difficult to translate it from resources to persons.

There are, of course, circumstances in which "the personal production view" might be very powerful. If, for example, we are asked to arbitrate between two children fighting over a wooden toy, which has been made unaided and with free wood by one of them, and if we know nothing more about the two children, then it would be not unreasonable to be swayed by the fact of "personal production."[32] Utilitarians (and many others) will claim that this appeal is entirely explainable by some instrumental reasoning. Whether this is so is unclear. What is clear, and cannot be doubted, is that there is a strong moral intuition in that direction. But no matter what this appeal arises from, the possibility of applying it to judging actual market outcomes is so restricted by the fact of interdependence and the contrast between owning and producing, that this approach may be of little use in practical reasoning.

Concluding Remarks

The moral standing of the market mechanism has to be related to results, and it is, thus, derivative and contingent. While it is important to examine the possibility that market operations might be justified on grounds of the exercise of peoples' "prior" rights (irrespective of consequences), the implausibility and the arbitrariness of that approach are difficult to avoid. I have argued for the alternative of assessing market operations in terms of achievements, but also for treating achievements much more widely than "welfarism" permits (including such factors as the importance of "freedom to choose"). This has the advantage of taking note of the moral force of some of the arguments presented by the "procedural" view, while making that force compete with other moral claims in the overall decision.

The second approach examined finds the moral standing of the market mechanism in the values of the outcomes. This is the standard approach in welfare economics, which then proceeds to take the more specialist form of

[32] I have discussed this question in "Ethical Issues in Income Distribution: National and International," in S. Grassman and E. Lunberg, eds., *The World Economic Order: Past and Prospects* (London: Macmillan, 1981); reprinted in Amartya Sen, *Resources, Values and Development* (Oxford: Blackwell, and Cambridge, MA: Harvard University Press, 1984).

judging the outcomes exclusively by the utilities generated. In terms of that general approach of "optimality," while a case could be made for saying some nice things about the market mechanism, it is hard to go beyond some highly tentative statements. The crucial issue turns out to be our assessment of inequality. The "direct theorem" ignores it. The "converse theorem" deals with it in a way that is self-defeating, insofar as the noninterventionist "moral" of the market mechanism is concerned.[33] Of course, we might refuse to judge the outcome in terms of utility information only. I have tried to argue elsewhere[34] against the "welfarist" method of evaluation of states of affairs. But the issue of inequality does have to be addressed, whether inequality is seen in terms of utilities, well-being, incomes, resources, or freedoms (including the real "freedom to choose").[35] The practice of avoiding this question through evasion or silence, on the one hand, or through peculiar definitions of "optimality," on the other, seems hard to defend.

The third approach that was examined is one based on "the personal production view." Despite the possible relevance and force of that moral consideration, it appears that this gives us very little help in morally assessing market mechanisms in a world with (1) interdependent production, and (2) owned impersonal resources.

The argument that is much harder to dismiss is one that claims little for the market mechanism except superiority over other *practical* alternatives. Samuel Brittan has argued that "too often the defects of real world market are compared with the hypothetical action of a benevolent and omniscient dictator (as frequently – in the more technical writing – for reasons of mathematical convenience as from any deeply held conviction)."[36] Indeed, it is not unfair to ask a critic of the market mechanism what precise system he would put forward *instead*, how well does it work, and how does it compare?

Once the issue is seen in this way, it is clear that the question of the moral standing of the market mechanism cannot be given the kind of simple answer that some of the approaches examined have tried to give. It might well be the case that many alternatives suggested as substitutes for the market mechanism would do worse than the market mechanism, even in terms of

[33] It is not surprising, in view of this, that the early contributions to the efficiency of the market mechanism came from socialist writers like O. Lange, "The Foundations of Welfare Economics," *Econometrica*, vol. 10 (1938); and A. P. Lerner, *The Economics of Control* (London: Macmillan, 1944).

[34] Amartya Sen, *Collective Choice and Social Welfare*; "Utilitarianism and Welfarism"; "Rights and Agency."

[35] On the last, see Amartya Sen, "Equality of What?"; Well-being, Agency and Freedom: The Dewey Lectures 1984."

[36] S. Brittan, *The Role and Limits of Government: Essays in Political Economy* (London: Temple Smith, 1983); p. 37. See also I. M. D. Little, *Economic Development: Theory, Policy and International Relations* (New York: Basic Books, 1982).

the criteria used by the advocates of the change. It is also possible that, in terms of the criteria put forward by defenders of the market mechanism, replacement of the market in many spheres by other procedures would do much better.

The Chinese produced chaos by trying to do away with some features of the market mechanism. At the same time, they did expand the positive freedoms of many. For example, despite a per capita GNP only a fraction (about a seventh) of Brazil's and Mexico's, China has succeeded, through an interventionist regime, in raising life expectancy beyond that of Brazil and Mexico. It is also higher than that of South Korea, a country with a much higher level of income and a much faster rate of growth (based on a market economy with an active government policy). If we look at actual achievements across the world, the picture is a divided one, and there are many conditional conclusions to be drawn based on such empirical comparisons.[37] The difficulties in making the comparisons arise partly from the problem of isolating empirical regularities, but also from the formidable complications in getting an adequate moral criterion in terms of which the instrumentality of the market mechanism and its rivals can be judged.

When all the qualifications have been put in, the market mechanism certainly has some instrumental moral relevance, related to its handling of information and incentives. The result-oriented and contingent nature of that relevance does not make the lessons unimportant. The defenders of the market mechanism have often seen in hesitant acknowledgments like this one a tendency to damn the market with "faint praise." But while faint praise is no doubt one method of damning, unjustified and ferocious praise is certainly another. The vigor of the defense of the market mechanism examined earlier in the paper is not matched by its ability to meet criticisms. It also distracts us from the contingent importance of the use of the market mechanism in many real circumstances, and tends to make us overlook the relevance of these lessons for practical reasoning. There *is* a case for *faint* praise – not any less, nor much more.

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[37] The question is discussed in Amartya Sen, "Public Action and the Quality of Life in Developing Countries," *Oxford Bulletin of Economics and Statistics*, vol. 43 (1981); and "Development: Which Way Now?", *Economic Journal*, vol. 93 (1973).