

# How can we analyse real world markets?

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**Abstract:** *The hegemony of neoliberalism has seen the market virtually canonised with mainstream neoclassical economics successfully shaping a general understanding of the market as being synonymous with the economy and capitalism more generally. But mainstream economics portrays the market as a normative ideal framed around a set of abstract assumptions incompatible with reality. This conception and assumptions have been roundly challenged and there is a burgeoning discourse cogently demonstrating that real-world markets do not emerge in some vacuum, are persistently vulnerable to failure, influence the nature and relationships of individuals, and their operation depends on highly complex non-market institutional arrangements into which they are deeply embedded. But economists have shown little interest, until more recently, in the ‘real constitution’ of markets. In seeking to analyse real world markets, this paper posits a method for empirical investigation to explain the structure, operation, interactions and outcomes of actually existing markets.*

**Keywords:** institutions, market structure, neoliberalism, neoclassical economics

**JEL classification codes:** B52, D40, H44

## 1 Introduction

The market is now considered by the vast majority of mainstream economists, policymakers, the media and politicians as being the far superior coordinating mechanism for all capitalist economies.

... by century’s end, to speak ill of markets narrowed one’s access to ears, and progressive economists quickly learned to reformulate criticisms as suggestions about improving market performance. Any hint that one considered markets to be part of the problem rather than the key to the solution to any economic problem was sure to blow one’s cover in the economics profession as well as policy circles (Hahnel 2007: 1140)

Free market fundamentalism has assumed “an almost biblical status” (Giroux 2009) and public policies have become embedded with market-based mechanisms based on economic concepts derived from the logic of perfect competitive markets. As a consequence there has been substantial change to markets which have traditionally supplied public goods such as electricity, water, education, health insurance, public housing, infrastructure, and services for the disabled, aged and unemployed. Most notably, direct provision by government of these goods and services has been supplanted and there have been significant pricing changes.

The rationale for these market-based policies has been couched in terms of the need for greater economic efficiency. Consequently contemporary public policies are almost exclusively framed in abstract terms of competition, efficiency, supply and demand, or the need to address market failures. This is the lexicon of neoclassical economics which portrays the market as a normative ideal framed around a set of abstract assumptions, where a market is conceived “as a space for carrying out identical transactions which bear on one well-defined product and lead to the determination of one price” (Coriat and Weinstein 2005: 2). But abstract terms, identical transactions, one product and one price cannot explain the operation and outcomes of these transformed markets which characterise contemporary capitalism.

Markets are not purely about relationships between inanimate objects, between goods and services, which is the strong impression evoked by any mainstream economics text or government publication. Markets involve people, their preferences (influenced by opinions, values and advertising) and relationships with others. Market prices also will influence people’s accessibility to, and participation in, a market.

Those markets, shaped by market-based public policies, determine – to a significant measure - the health, standard of living and social inclusion of the population. How can we understand, and explain the impact on society, of these ‘restructured’ real world markets given that economists have, until recently, shown little interest in the “emergence and real constitution of markets” (*ibid*: 1)?<sup>1</sup> How are actually existing markets organised? What ensures their ongoing functioning? What is the nature of the goods and services provided by these markets? How does this differ from previous provision? What issues or barriers do participants encounter when engaging with these markets? To what extent do these markets ensure adequate provision to those on lower incomes? What outcomes are these markets delivering?

The purpose of this paper is to develop a framework for empirical analysis of real world markets to explain the structure, operation, interactions and outcomes of actually existing markets. “A clearheaded perception of how different institutions actually work ... from the market to the institutions of the state” (Sen 2009) will establish a credible foundation for the development of options to ameliorate the impoverishment of capitalism and its “greed, cruelty, corruption and iniquitous power relations” (Giroux 2009).

The paper is structured as follows. Section 2 focuses on the conceptualisation of the market and discusses the shifting attitudes to the notion of the self-regulating market held by mainstream economists and policymakers and hence, their perception of the relationship between market and state. This leads to a discussion of the success by neoclassical economics, during the hegemony of neoliberalism, in shaping a general understanding of the market as being synonymous with the economy and capitalism more generally accompanied by a set of assumptions incompatible with reality. Challenges to the neoclassical conception are outlined which situate the market as one of capitalism’s multiplicity of institutions. Drawing from the multiplicity of meanings which may be attributed to the market, and other related dimensions, Section 3 distinguishes twelve key delineating features of markets from which a framework to analyse actually existing markets is posited. A final section provides concluding comments.

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<sup>1</sup> The few notable empirical studies have included Garcia-Parpet (2007), Kirman and Vignes (1992), and PSIRU (2008).

## 2 How is the market conceptualised?

### 2.1 *The oscillating conceptions of 'self-equilibrating' markets*

The 1930s Great Depression “called into question the predominant conviction that government should balance its budget, maintain the gold standard, and let business reequilibrate of its own accord during economic downturns” (Weir and Skocpol 1985: 107). Most economists held the view that governments should let markets function free of institutional impediments because ‘free markets’ were not the cause of economic instability and/or stagnation.

After the Second World War, there was a 180 degree turn in this thinking with the widespread adoption by democratically-elected governments of Keynesian economic management. “Its central feature was acceptance of the so-called mixed economy – that is, a capitalist framework within which state enterprise was tolerated and the government held responsible for managing the economy” (Armstrong, Glyn *et al* 1991: 136). The approach of governments became one of using regulation, legislation, collective agreements, and monetary and fiscal policies, to ‘manage’ market mechanisms which if left ‘untamed’, it was advocated, would not provide full employment, steady growth and economic stability. This economic management approach redefined the roles of the state and the market because it rejected the notion of the capitalist economy having a self-correcting ability (Whitwell 1986: 38).

But, from the 1970s onwards, there has been a very marked shift by mainstream economists and policymakers to the notion of ‘free and unencumbered’ markets being the most efficient method to coordinate the activities of contemporary capitalist economies. Nearly all mainstream economists believe – at least until the 2008 admission by former Federal Reserve Chairman Greenspan of a ‘flaw’ – that markets are self-correcting (Skidelsky 2009). The market had risen, to borrow from Boyer (1997), like a phoenix. Consequently, government intervention has been increasingly portrayed as detrimental not beneficial to efficient market operations as the ideology of neoliberalism has metamorphosed into the “central guiding principle of economic thought and management” (Harvey 2005: 2). The relationship of the state to the market is a core idea of neoliberalism. The market has primacy and virtually all economic and social problems are seen as having a market solution. However, neoliberals recognise that “market order requires a particular kind of state to secure it” (Gamble 2006: 22), a strong state to overcome obstacles and provide necessary support to ensure a ‘free’ market is paramount.

### 2.2 *The neoliberal market and neoclassical economics*

Market discipline, competition and commodification denote neoliberalism which has been described as:

*a mixture of neoclassical economic fundamentalism, market regulation in place of state guidance, economic redistribution in favor of capital (known as supply-side economics), moral authoritarianism with an idealized family at its center, international free trade principles (sometimes inconsistently applied), and a thorough intolerance of trade unionism (Moody 1997: 119-20, emphasis added).*

Four basic concepts underpin neoliberalism - the free market, market failure, market primacy, and interrelationships of market, state and politics (Chang 2002). But the definition of

the free market, and thus state intervention, is fraught with difficulty because: (a) the participants, and terms of participation, in all markets is determined by some form of state regulation; and (b) the same action by the state may be considered an intervention by one society but not another, depending on the legitimacy and hierarchy of the underlying rights-obligations structure for market participants (*ibid*). The definition of market failure is similarly fraught, in Chang's view, because the notion of failure only makes sense in relation to what is considered to be an 'ideal' market (Chester 2008c). But, as Chang demonstrates, that regarded by one person as failure (e.g. income inequality) may be seen by another as the normal functioning of the market.

Neoclassical economics has been criticised by the 1991 Nobel Economics Prize recipient for its increasing abstraction of analysis and preoccupation with price determination resulting in study of "a system that lives in the minds of economists but not on earth ... The firm and market appear by name but they lack any substance" (Coase (1992: 714). Nevertheless, neoclassical economics has successfully shaped

the general understanding of what a "market", a "market economy", and even an "economy" in general is, or should be. In its basic approach, it hardly has anything to do with the reality of markets ... however, it has been made ... into an official economic thought system of capitalist-market economies and, thus, a *general theoretical and normative reference and benchmark* for economic analysis, economic systems and policies. This justification of the "market" has been achieved through the definition of a *decentralised economy* in which *prices* play a central role as coordinating devices ... While the "market" is an *ambiguous positive-normative ideal*, it nevertheless is considered not only an adequate reflection of the capitalist-market reality but also serves as a sound policy guideline for its reform (Elsner 2008: 370, original emphasis)

But what does neoclassical economics tell us about the market? First, it assumes that products are optimally allocated in a perfectly informed, atomistic world. Second, the market is attributed self-equilibrating properties because it is assumed to clear automatically via price adjustments i.e. prices respond to changes in demand or supply, finding equilibrium at the price at which the quantity supplied equals the quantity demanded. Accordingly, these oscillations underpin a systemic stability across markets for all goods and services and ensure an optimal allocation of resources between competing needs. Yet this self-equilibrating nature of the market rests on numerous assumptions such as identical consumers behaving rationally because they are perfectly informed about all the available alternatives, zero transaction costs, no trading at disequilibrium prices, and infinitely rapid velocities of prices and quantities (Blaug 2002: 40-41). In addition, it is assumed that communication between market participants is solely through price signals, market participants are anonymous, interaction in the market is horizontal, virtually all transactions are commensurable, all goods are non-collective and the market is not place sensitive (Crouch 2005: 115).

These assumptions mean that market equilibrium can only be achieved if multiple conditions are fulfilled such as: numerous traders so that no one can exert any monopoly power; a finite number of goods and their quality is common knowledge; there are no public goods or externalities of production; returns to scale are constant; all equity issues are completely separate from the objective of efficiency; and, the preferences of buyers and sellers are convex i.e. marginal utility of any good and the marginal productivity of a factor must be declining concurrently (Boyer 1997: 72-74). This means that multiple and quite precise conditions are necessary to guarantee optimal market equilibrium.

Notwithstanding any perceived incompatibility of neoclassical assumptions with economic reality, this paradigm maintains that the market should be left 'unfettered' from

state interventions to ensure its 'efficient' workings are allowed to determine output and price. Free, competitive markets allocate resources and distribute income most efficiently, it is argued, because they will tend towards a (Pareto) optimal situation which occurs when no change can improve the position of one individual (as judged by herself) without a negative impact on the position of another individual (as judged by that individual).

However, six sources of market failure which threaten the achievement of 'Pareto efficiency' have been deemed to warrant government intervention. These are: a failure of perfect competition; a failure to supply public goods (e.g. defence or national security); negative externalities of production such as pollution; markets which provide incomplete goods and services (e.g. insurance); imperfect information to consumers (e.g. weather forecasts); and, 'macroeconomic disturbances' such as high levels of unemployment and inflation (Stiglitz 2000: 76-90). The notion of environmental problems as negative externalities arising from market failure provides a strong exemplar of the policy approach advocated by mainstream neoclassical economics. This less than optimal market outcome, according to mainstream neoclassicists, can be 'corrected' with the imposition of economic incentives to create the 'correct price' which will reduce externalities and lead to some optimum level of environmental control. More recently, this view of environmental problems has been challenged by one that contends ill-defined property rights cause markets to fail, and clarified rights will enable negotiation between parties in 'free markets' (Hahnel and Sheeran 2009).

But, it is only in these circumstances of market failure – which jeopardise the holy grail of economic efficiency – that justify any government intervention for mainstream economics.<sup>2</sup> Government intervention is, according to this view, not warranted to "protect its citizens from misfortune and the random blows of fate by providing the most basic rights and levels of collective security and protection" (Giroux 2009). The issue of market failure is of greatest importance to neoclassical economics because this school is about the market and the market is the economy; "if the market fails, the economy fails" (Chang 2002: 545).

### 2.3 *Markets in the real world*

The neoclassical conception of the market, and its incompatible assumptions with reality, have been roundly challenged (e.g. Blaug 2002; Goodwin, Nelson *et al* 2005; Prasch 1995; Simon 1991; Sherman, Hunt *et al* 2008). There is also a burgeoning discourse cogently demonstrating that real-world markets do not emerge in some vacuum, are persistently vulnerable to failure, influence the nature and relationships of individuals, and their operation depends on highly complex non-market institutional arrangements into which they are deeply embedded (e.g. Altvater 1993; Boyer 1997; Coriat and Weinstein 2005; Martinez 2009; North 1990; Peck and Theodore 2007; Prasch 2008; Tsakalotos 2004). Moreover, self-regulating market mechanisms cannot coordinate fictitious commodities such as money, labour and the environment because their supply is not in response to changing relative prices (Polyani 2001). A group of sociologists have also initiated detailed analyses of the actual creation and functioning of markets, especially financial markets, which have debunked neoclassical notions of markets being atomistic and anonymous, showing instead a range of behavioural rules, relationships,

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<sup>2</sup> Stiglitz (2000: 87) also argues that even if Pareto efficiency is achieved, government intervention may be warranted to achieve greater equality of income distribution and/or if the government "knows what is in the best interests of individuals".

and skills required for participation (e.g. Callon 1998; Callon, Millo *et al* 2007; MacKenzie 2007a, 2009; MacKenzie, Muniesa *et al* 2007).

This body of work situates the market as one of a multiplicity of formal and informal institutions comprising capitalism. “All institutions, including the market ... are defined in relation to the structure of the rights and obligations of the relevant actors” (Chang 2007: 7) which in the case of the market includes the institutional arrangements that determine and/or regulate market participants, and the objects and process of market exchange. As these ‘rights and obligations’ are deemed to be the result of politics, the market – like all institutions – is considered to be a political construct. Property rights, and the entitlements bestowed on market participants are not free of politics, nor are the determination of interest rates and wages which impact on every sector of the economy, along with numerous state actions to ‘protect’ market participants. Far from being ‘natural’, “markets are the fruit of complex social and historical developments” (Coriat and Weinstein 2005: 1) with politics, and thus the state, being integral to their creation and functioning.

Consequently, this view of the actually existing market assigns a far more active role to the state. Market outcomes result from a myriad of institutional arrangements and processes all of which are influenced by the state and politics. Accordingly, a view of market outcomes solely in terms of output and price provides a partial, and thus inaccurate view, of economic reality. Therefore, if we are to provide a more accurate view, and not framed in abstraction, how can we analyse a market?

### **3 How can we analyse a market?**

Boyer (1997: 62-66) contends that at least six different ‘types’ of markets are distinguishable by the space and time horizon in which the market occurs. Markets may be: periodic and itinerant (e.g. antiques, food); a temporary ‘screening’ device to procure the least costly of proposals and which then become a bilateral commercial contract (e.g. infrastructure); an aggregation over a geographical area or for one product (e.g. the beef market); an abstract mechanism to make compatible a series of ‘individual supplies and demands’ which adjusts and converges to a unique price (e.g. the abstract market of neoclassical economics); a set of interdependent markets (e.g. a population expresses joint demand upon thousands of commodity markets); or, a market may exist whenever social actors compete for limited resources, positions or status (e.g. the application of rationality, equilibrium and market by the Chicago school of economics to marriage, crime, donations to churches etc). Thus the market is polysemic, it has a multiplicity of meanings because of the differing location and temporal nature of markets. If we are seeking to understand real world markets, this aspect signals the need to delineate a market’s space and time horizon.

Three other contributions also signal further aspects to illuminate the workings and outcomes of real world markets. According to Prasch (2008) the analytical key to understanding market relations lies in the evolving system of property rights and contract law which have created increasingly complex markets. The organisation of economic exchange, through the two dimensions of the formation and differentiation of economic agents around the exchange process and differences in the specificities of exchange processes, is posited by Harvey and Randles (2002) as a possible – albeit more abstract - framework for analysis. On

the other hand, Tordjman suggests 'embedded behaviours' will "circumscribe the domain of markets' (1998: 2) which can be illuminated by considering the ways in which the object of exchange are defined, the market participants, market processes and how society is shaped by markets.

Drawing from these propositions about space and time, the influence of property rights and contract law, the dimensions and embedded behaviours shaping the organisation of exchange, twelve core features of markets can be distinguished. These features progress from the relatively simple to the more complex but enable us to move from the abstract to the more concrete if the intent is to undertake an empirical analysis of real world markets. The twelve core features of markets are presented in Box 1 below.

#### **Box 1: Distinguishing features of markets**

1. A market is a location where **buyers and sellers interact**.
2. A market may be a physical **location** but does not need to be as evidenced by eBay, an internet auction.
3. Goods may be bought and sold on **local or global** markets.
4. A **commodity** market requires a **monetary system**.
5. Markets may be for **intermediate or final goods**.
6. **Exchange** – of some **object, promise, service or privilege** – is the fundamental event in a market.
7. A market is a **locus of repeated exchanges**.
8. What may be exchanged in a market will depend upon a **legal system of property rights**.
9. **Implicit or explicit contracts** govern the conditions under which property is exchanged.
10. **Rules about transactions** organise how buyers and sellers interact, and who may be a buyer and a seller.
11. **Organised behaviour** allows continuity of market operation.
12. **Rules about the provision of information** (including about the quality of the good) enable sellers to propose a price and enable buyers to accept or negotiate another.

These twelve distinguishing features of markets encompass rules about transactions and information, the nature of goods, mechanisms to facilitate exchange, property rights and space. More importantly, these features, I suggest, foreshadow a concrete form of Tjordman's (2004) 'agenda of questions' to address if we are to develop a realistic understanding of actually existing markets. These questions provide an analytical framework and are presented in Box 2.

### **Box 2: Questions to analyse actually existing markets**

- What is the commodity 'bought and sold'? How are these goods or services defined? To what extent have these definitions changed with the "virtual canonization of market organisation" (Nelson 2005: 1)?
- Who are the market participants (individuals, groups or organisations)? Who transacts with who? Are intermediaries involved?
- What are 'rules' or protocols which determine eligibility or ineligibility for ongoing access to a market? Are there legal and political decisions, or compromises, which determine who participates?
- How does the interaction between 'buyers' and 'sellers' take place? Are particular behaviours forbidden? Are there implicit rules influencing the behaviour of market participants?
- Is there a physical or virtual market location and how is this organised? Is the sphere of interaction local or global
- What are the institutions, organisations, legislation or associations that organise the functioning of a market, as well as their responsibilities and enforcement tools to 'make the market work'?
- How is price determined? Are prices set outside or in the market? If it is a price-setting market, does this lead to different bilateral prices?
- What is the form of competition in each market in light of the number of traders, distribution of ownership and market power?
- What information is available to whom? Where is it available? What skills are needed to access or process market information?
- What is the role of the state?

It is my contention that an analytical grid is presented by these questions which can be used to dissect the structure, operation, participants, behaviours, rules, price setting and more to provide a realistic picture of real world markets. In comparison, neoclassical economic analysis assumes a form of market organisation – pure competition, duopoly, oligopoly, or monopoly – and then analyses output, price and cost outcomes within this context (Gould 1980).

This analytical grid has been applied to five Australian markets, four of which are longstanding markets previously providing goods and services directly and solely by government (electricity, water, housing for low-income Australians, and services for the unemployed) and the other is a market currently being established (carbon trading) (Chester 2009). All five markets have, or will have, a widespread impact across the Australian community.

The analysis unequivocally demonstrated a very different picture of the operation and outcomes of markets from that promulgated by mainstream economics which is embedded in public policy. For example (*ibid*):

- eligibility to participate in a market is not met by the setting or payment of a price but by first meeting pre-determined criteria, usually set by regulators;
- ongoing market participation is not assured even if eligibility criteria are satisfied and payment is made for a good or service;
- government is directly influencing the demand and supply sides of each market analysed;
- regulators actively determine prices in each of the five markets analysed;
- intermediaries are strongly evident and commonly as market operators;
- the vast majority of interaction between market participants is via the internet;
- quite complex and detailed information is available to buyers relating to their participation, obligations, payments terms, penalties and performance data about suppliers;
- each market is structured around a very complex legislative and regulatory regime;
- there is strong evidence of different market types and the extent of competition includes contested and managed markets, monopoly franchise, oligopoly and imperfect competition;
- government is a very dominant participant in all markets, performing multiple roles as regulator, owner of significant supplier assets, manager of stock, manager of contested markets, market operator, and buyer;
- despite government interventions, and significant price increases, the key outcomes in the majority of markets analysed show that supply is not meeting demand and one market (housing for low-income Australians) is evidence of chronic market failure; and
- market power and concentration was found to be strongly present in the majority of markets analysed.

The analysis strongly illustrated that there is not one but a spectrum of contemporary market configurations and exceedingly complex governance regimes. Thus, the organisation of a capitalist economy, such as Australia, which attributes a leading role to competitive markets,

can only be explained by ascertaining: the institutions, legislation, organisations, or interactions that organise the functioning of various markets; the series of commodities for which the supply and demand of is heavily determined by market institutions, including regulation by the state; and the forms of competition according to the number of traders, ownership distribution, market power, and the mechanisms to resolve capacity issues or structural changes (Boyer 1997: 70). These are the 'keys' to understanding and explaining the existence and operation of markets in a capitalist economy.

#### **4 Concluding comments**

In the 1930s most economists were of the view that markets were self-equilibrating, not the cause of economic instability and government should, as they did, let markets function free of institutional impediments. Post World War 2, Keynesian economic management rejected the notion of the capitalist economy having a self-correcting ability. However, with the ascendancy of neoliberalism from the 1970s onwards, the rhetoric of mainstream economists and policymakers has strongly admonished government intervention as detrimental to efficient market operations with the market advocated as the solution for virtually all economic and social problems. Mainstream neoclassical economics has very successfully portrayed the market as synonymous with the economy and capitalism but as a normative ideal framed around a set of abstract assumptions. This does not explain the structure, functioning, outcomes or implications of actually existing markets.

The market has a multiplicity of meanings which yield the following features – a location for repeated exchanges between buyers and sellers which may be physical or virtual, may involve intermediate or final goods, may be local or global and which is underpinned by property rights, implicit or explicit contracts, rules about transactions and information creating organised behaviour and continuity of operation. It is these features which signal a set of questions to address in order to generate a realistic understanding of the structure and operation of actually existing markets. This is the analytical framework which this paper has sought to develop.

The analytical framework posited explicitly recognises the different types of markets that can be discerned, the relationship to property rights, and the dimensions and behaviours shaping the organisation of exchange through the delineation of twelve core features of markets. These features establish the set of questions which frame and guide the analysis.

It is also abundantly clear from the foregoing discussion, and the albeit brief discussion of the analysis of five Australian markets, the market is such a complex institution that it cannot be distilled or equated to the sum of bilateral relationships as is neoclassical economics' want. A market's functioning and 'constitution' can only be understood within the context of this empirical complexity as well as by reference to other markets given the diversity and specificities of each. The analytical framework posited in this paper contributes a basis to do that.

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