A free market requires voluntary actions

Essay-style Submission for APEE Conference: Capitalism: Free-Market or Crony?

Abstract

This paper draws attention to the importance of the understanding of voluntary actions in the free market construct. Failing to understand the role of voluntary actions in the free market construct will often result in discussions of capitalism versus socialism focusing on asset ownership and not consumer sovereignty. I argue that asset ownership is less important than true consumer sovereignty, which again is the essential argument for why capitalism is the superior mode of resource allocation and social organization. The paper analyzes how our understanding of markets and voluntary actions are essential to the construct of consumer sovereignty. Understanding the degree of voluntary actions in a given commercial setting has implications for both business strategy and policy making. This paper thus aims to contribute to explain why restricted markets become crony capitalism.

Keywords: Commercialization, free markets, strategy, sales, public policy, consumer sovereignty, social orders, language studies

Introduction

A less than desirable consequence of the modern method of social sciences is that many of the interesting research discussions had in preparing papers for journals are omitted in the final installment. This paper is an attempt to salvage such a discussion from the dung heap of social science. In a recent forthcoming study I did with Associate Professor Henrik Sornn-Friese and Professor Thomas Ritter on defining commercialization in product innovation management many elements went into and out of the definition. The one element which we had the hardest time with was the question of whether commercialization relies on voluntary actions from other market actors. Ultimately we left it out. Being management scholars we investigate what the world is. No matter what ones moral sentiments might dictate. It is a proven fact according to our study that one can commercialize products without any voluntary desire or action on behalf of its customers; that might just be the true difference between a free market and crony capitalism.

Theories of scientific discovery as diverse as Popper (2005) and Kuhn (2012) agree that science advances when we question currently held beliefs. However this process is often hindered by taking elements of these beliefs for granted. This is a very real issue for students of market structure. All too often proponents of free markets find themselves in a discussion based around ownership among the potentially equally self-serving institutions of government and private companies. My claim is that ownership is not the relevant distinction between free markets and its alternatives. Rather voluntary actions, on behalf of decision making consumers, are. As a scholar of free markets it is a very forgivable omission to assume that market transaction are based on voluntary actions; that is consumers are not coerced into making a purchase but does so purely based on expected or even true utility from unhindered personal preferences. Any constraints are freely chosen moral ones, such as the respect of the property rights of others. If nothing else this paper is drawing attention to how "voluntary actions" and "market transactions" are actually separate theoretical constructs and that only together can they make up what can constitute a "free market"; "free" is the voluntary part.

The Market Construct

I will begin my argument by analyzing what a market is, before adding voluntary actions, to arrive at the free market construct that I ultimately want to address. For a market to be relevant, there must be a surplus supply offered for trade. This is, however, a too narrow definition of a market. Consider the old proverb "the world's oldest profession" referring to prostitution. Here is the idea that the oldest profession, and hence market, is offering sex for trade because you are willing to produce a surplus supply of this service. The production of satisfaction supply if you will. But the proverb is misleading; in order for the proverb to make sense, there must be a distinct skillset removed from the supply of satisfaction. That is the skillset of selling or commercializing. If the world's oldest profession is selling sex, selling is before supply or production of sex in being the even older profession. In other words a market requires both a supply and a commercializing of said supply.

Another attempt to define a market is that it is a social institution for value capturing. Again, we can disprove this. That one agent captures value is not contingent on a market transaction. The best way to disprove this is by making an, often used, but too seldom realized, mistakenly simplified market model; that to portray the market as a game. A market order is very different from such, but let say the market were a game with two players each starting with a set of resources. Such a game can have three rational outcomes; 1) one player is richer at the expense of the other, or both are poorer, that is a negative sum game. 2) Neither player is no better, or worse, off, that is a zero sum game, or 3) both players are better off, which is a positive sum game. Several important design characteristics shows us why no game designer would compare a game to a market. Mainly, 1) transactions in a market are often repeated, 2) there are other players who compete for the starting resources, 3) players can refrain from trading, 4) there is not one winner at the end but rather there is no end, no defined turns, and no definitive winners or losers. Rather than talking about value capture, competition in the Hayekian (Snow, 2002) term, meaning conflicting interest competing for resources in a continues state with unknowable outcomes serves us better for limiting our construct.

To summarize; a market facilitates the commercialization of surplus supply in a never ending competitive setting. I will now go on to explain why voluntary actions are needed in order to add “free” to the market construct. I will be focusing mainly on the commercializing aspect in the remainder of this paper. The first question that arises is whether it is a market setting when sales occur? Again the answer is no. Sales without voluntary actions on behalf of the buyer are, not only theoretically possible, they occur often. Some economist might argue that in theory you can only sell to agents who believe that their welfare will be improved by accepting your offerings. To the untrained eye that looks like voluntarism is build into sales, but it is not. You can easily setup a condition where not buying will prevent another action later and hence the buying is not done from free will. Using anonymous, but empirical, cases I will deal with such in the following section.

Non-voluntary Buying

The easiest example of non-voluntary action in a market is that of government mandated buying. Taxation is an example of such. After all, no taxman on horseback is riding around taking a penance at gunpoint. Today the situation in many countries is more; if you or your employer, as the case might be, do not pay your government subscription, you will be seriously hindered in doing any other actions on the market – mainly from the fact you will be jailed. We can benefit from seeing taxation as forced buying of certain services. But forced buying also works in a less strict sense. Imagine a manufacturer of air filters. This company has come up with a new product that lowers CO_2 emissions from pig farms. The potential benefit from this is a public good but the cost is carried by the individual farmer. One commercial strategy of such a company could be to make the government pass an environmental law requiring to, maybe not directly buy the filter, but to produce under a certain threshold CO_2 emissions in order for a pig farm to be allowed to operate. Now the farmers will likely flock to the company that will in a "private" market sell the filters. This is nothing but a more advanced form of mandated or forced buying and the market size directly correlates to the law.

Next example of non-voluntary buying is that of regulated buying. This is most easily illustrated by the pharma industries. Today drugs are not allowed to be sold unless approved by the FDA and other such government bodies. This process takes time and adds cost that needs to be recovered. That means that consumer demand, say to end headaches, is not being offered the currently best cure or at the best price, but only the cure currently approved and at a large mark up for the time to get approval. The odd thing is that regulated buying scenarios are often propelled under a guise of consumer protection. Today for instance a drug is only allowed to have one effect to get approved. That means a pill like Aspirin which have 28 known positive effects would not be approved as one product today but rather as 28 products, requiring a consumer to buy more. If the consumer were free to voluntary dispose of her income, she would likely not buy products this way.

A further example of non-voluntary buying are markets with only one solution. As economist knows there is never only one solution. There is for instance always the solution to abstain from transacting. Economist also know that if the rent from the supply is attractive enough new entrants are attracted, providing more choice and lower prices. Yet one solution scenarios exist and are prosperous. This can be demonstrated by a bridge example. Alternatives exist but they are unrealistically costly like flying or sailing to be true alternatives. Let say the chosen policy of a country is that only the government is allowed to decide where roads run. The government decides to contract the construction and operation of the bridge to a private contractor. This contractor does need to commercialize the bridge product, but it is just a matter of putting up a toll collection booth. This is oddly enough a commercial transaction but it is not, in any realistic sense, a voluntary one.

The last example, which is more tricky, is buying mandated by spontaneous social orders. These are described as “rules of thumbs” by Hayek (1956, 2012). Orders, both mandated and spontaneous are, what makes it possible to live in a society of competing interests. While few doubt the superiority of spontaneous orders in complex purposeless social settings, and the superiority of mandated orders in directed social settings like organizations, there is an overlooked feature for the spontaneous orders; we cannot guarantee that they are freely chosen. Their high organizing powers comes from the fact that for the large part agents do not need to spend mental resources thinking about them. However this also entails that such orders for the majority are not consciously chosen, and hence as social observers, we cannot guarantee that they are freely chosen. Say all your potential partners only dates people in Nike sneakers, while you hate Nike sneakers preferring the much more stylish choice of Adidas trainers. Note that here is no law that requires you to buy Nike. You can easily survive in pretty Adidas trainers but if you want to enter the dating scene you need to pay for Nike’s somewhat lacking aesthetics. If the agent is aware of the social order mandating the Nike option and decides his commercial transaction based on this it is a free choice, but if not, we cannot know if the choice is truly free.

The vast majority of males wears pants to work and hence will never consider buying a dress for this purpose. In most jobs there is nothing hindering the executing of the task while wearing a dress so the social order is just that, and while Hayek’s point is valid in that it is efficient for the agent not to think about pants or dress when work clothes shopping we cannot argue the choice is free until the agent reflects upon it and decides to favor pants or at least not the social uneasiness that comes from wearing a dress. A more applied example is found in oil production where concessions are given by the state to Exploration and Production companies (E&Ps), who, in turn utilize a large specified supply chain of independent sub suppliers. The fact that the concession is given provides a social order where suppliers expect E&Ps to adhere to local content and generally make the market profitable and attractive for suppliers of the nation who gave the concession. This creates a culture and subsequent social order where the commercial choice among private enterprises is not free. The question of social orders and voluntary action in purchasing might seem a finer point, but it is a point none the less.

A market under influence of social orders is not guaranteed to be a free market just from being spontaneously ordered. If you are a sales agent in either of the above settings you are not acting in a free market, and, from a management point of view, the tools and methods of sales you are using are likely to differ from those advisable in a true free market. This is an important observation for management science, and might be where it truly differs from the more “pure” discipline of economics. The latter deals with the institutions that shape welfare optimizing behavior. The former can deal within institutions and can to some extent ignore the moral imperative for free markets.

The Sovereignty of Consumers

Theoretically the best framework to describe why and how free markets serves all best, but also how it can become crony capitalism is, besides Hayek’s beautiful description of the knowledge transfer via price mechanism (1945), the concept of the sovereignty of consumers. The concept of the sovereignty of the consumer envisioned by Hutt (1936) and developed by Mises (1949) and others states that while both producers and consumers have a power relation toward each other, it is ultimately the consumer that has the real power as consumers over time decides who gets to be producers. The consumer has the sovereignty in a free market. Crony capitalism happens when the consumer is not sovereign.

To explain this very important statement we must examine the concept of sovereignty. While this was outlined by Hutt, his analysis can stand to be expanded. Hutt writes his concept in a more simple time and this is reflected in his theory. Hutt writes in a time before the welfare state. Basically in that time you had government monopolies and free commerce, and Hayek had yet to point social orders out to us. Today we see a third version where even free commerce is often shaped by government policy given the transaction only the outwards appearance of trade, while in fact the producer has usurped the sovereignty of the consumer by lobbying for or just better understanding the market shaping legal regime and social orders. This is a complex area and many advocates of market shaping legal regimes will claim that they in fact serve the consumer. This paper will not touch more on that but simply note that in order for consumer sovereignty to work, it must be based on voluntary action in as extreme an extent as envisioned. The reason I make this claim is that the only way sovereignty makes conceptual sense, is if it is in fact grounded in a sovereign relation and not bestowed. It is not politicians that makes consumers sovereign, but they can make them serfs.

The king in the era of absolutism was sovereign. He could decide anything and as long as he could envision and act on his vision his sovereignty was limitless. If he gave up hope he would succumb to the world, but other than that he was a god king. This is the ideal for a consumer’s rule in a free market. But if economics deals with the optimal allocation of limited resources, why an absolute king, a human with limited resources, as the model? While the kingdom might only on the outside seem to contain a fixed resource bundle, the king could, if he had the vision expand that bundle. He could go to war, make his kingdom attractive to business, take on debt, devaluate the currency (in the very real meaning in the time of the gold standard) and so on. As long as he had vision and acted his resource bundle were far from finite. The consumer is in a free market just as sovereign. He too can aggress, he can work harder or smarter, he can take on debt, and so on. As long as he can envision and act on his vision he can, ceteris paribus, be said to be sovereign. Keep in mind that including the act part ensures survival. By act, I mean obtaining success. If the consumer is not able to convince a banker to finance him beyond his current means he might have the vision but have failed to act on it.

If we set such a consumer in a market with limited voluntary action, he is no longer sovereign. Sovereignty cannot be given. It is inalienable. But like a king can lose his crown, so too can sovereignty be lost. To illustrate that point, imagine having access to a bundle of dollars and having a cold to cure. Assume the bundle is limitless and the cold ongoing. The sovereign consumer could finance the cure for the cold with no restrictions. To relax the assumptions a bit and limit the bundle of cash but assuming that colds are commonplace, he can buy an already existing cure with no restrictions. Now enter regulation saying that all cold medicine must be approved by the government, or that only doctors trained by the government can order the needed ingredients or any version of this. Now even in the first example of endless cash the consumer is no longer sovereign. Cash propensity is not the basis for sovereignty – voluntary actions are.

Some evidence could suggest that this has been known long before the theoretical advent of capitalism, and way before its current so predominant ugly cousin of crony state corporatism. In Danish the word for "buy" is "køb". Our traditional word for a sales person or business man is "købmand" or "buying man". Note it is not "selling man". One explanation could be that a business man buys low and sells high, but seeing as the word is also used to describe groceries, it could also be that the word describe market exchange as being inherently customer-centric. A "købmand" is where you go to buy what you cannot produce yourself. We see the dominance of consumer sovereignty in such a language use. In table 1 I did a language study of European languages and we see that in ~33% of the surveyed European languages the relation seems to exist where commercialization is not selling to consumers, but consumers buying from a vendor. This is in stark contrast to the modern English word of "merchant" which comes from the Latin "*mercari"* which means to trade and has an inherent relation to negotiation. Interestingly in Old English we do see the connection too.

[INSERT TABLE 1 HERE]

Hayek describes languages as spontaneous orders themselves. As such they reflect the society that formed them and found them useful. We can probably never truly know why words formed like they did, but looking again at Tabel 1, we see the "buy"-connection in mainly Germanic languages, but less so in Latin ones. One theory could be that Latin society quickly evolved to a level of specialization where words describe professions (Roberts, 2011), whereas in the Germanic societies a person could rarely hold one specialized profession for a longer time. A typical person might in the course of a year be a farmer, a trader, a hunter, and a warrior and hence the language was used to describe *functions* rather than *professions*. An illustration is found among early Vikings which could be both peaceful traders and fearsome raiders on the *same* voyage (Bately & Englert, 2007).

Implication and Suggestions for Further Research

At this point, I like to draw attention to the implications of understanding voluntarism in markets for both operators in commercial transactions and policy makers. I will comment on the former group first, operating in commercial relationships, be it as sales agents, managers or owners. These people must aim at securing the most return on their efforts. If you are a sales agent in any of the above settings what you are acting in is not a free market, while commercial, and from a management point of view the tools and methods of sales you are using likely to suit you better are different from those advisable in a free market. While a moral case can easily be stated that commercialization ought only to be done based on voluntary actions of consumers (Smith, 1991, 2010), and it is in fact only if such is the case that business is socially and morally right, we must also be realistic that people are self-serving and if a path is legally and socially open that will guarantee revenue by using non-voluntary or directly coercive methods such a path should be pursued by profit-seeking entities. It will make such options apparent to commentators. It is the responsibility of the latter group, policy makers, to make sure such options do not exist. By policy maker I simply hold whatever third party to a transaction that might via legal or other measures impact such possibilities.

Therefore, I suggest that a modern way to measure free markets is the degree to which purchasing powers of consumers are sovereign. It should be by skilled and knowable national statisticians be possible to construct how much of a citizens yearly income is spent on non-voluntary transactions and compare such a finding from country to country. The model could be very straight forward where average yearly income is deducted the section of the income that is only discounted freely purchased. I will hold that measuring consumer sovereignty is a very important measure to estimate the likely socially beneficial effects of market economies. To support such efforts the area of social orders and their impact on buying behavior could also hold important future insights for both management scholars and policy makers.

Conclusion

In the above I have argued that we miss the important aspect that generates the superior social outcomes of capitalism to state intervention if we assume that a market economy is free. To assume a free market, as in transaction are voluntary, just because ownership of assets are not directly attributed to the state, is misleading for the further analysis of both commercial strategy and public policy. Instead I have drawn attention to why transactions are insufficient to denote a free economy and how various transactions are not free. In fact, the beneficial aspects of capitalism for consumers comes from their sovereignty. I have argued that this knowledge is actually embedded in Germanic languages reflecting the important distinction between business as a profession and as a function.

Finally I have outlined how the level of consumer sovereignty does not matter for business operations but can potentially be measured as a policy indicator.

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Tables & figures

Table 1: Relation of Buy

Status	Language	Buy	Merchant	Match
Semi-official	Basque	Erosi	merkataria	
Non-EU	Bosnian	kupiti	N/A	
Official	Bulgarian	купувам	N/A	
Semi-official	Catalan	Compra	adroguer	
Official	Croatian	Kupi	N/A	
Official	Czech	Koupit	kupec	x
Official	Danish	Køb	Købmand	x
Official	Dutch	Kopen	koopman	x
Official	English	Buy	Merchant	
Official	Estonian	Ostma	N/A	
Official	Finnish	Ostaa	kauppias	
Official	French	Acheter	marchand	
Semi-official	Galician	Mercar	N/A	
Official	German	Kaufen	Kaufmann	x
Official	Greek	Αγορά	έμπορος	
Official	Hungarian	Keres	kereskedő	
Official	Irish	Cheannach	grósaeir	
Official	Italian	Acquistare	mercante	
Official	Latvian	pirkšana	tirgotājs	
Official	Lithuanian	pirkimas	pirklys	x
Official	Maltese	Buy	merkantier	
Non-EU	Norwegian	kjøpe	kjøpmann	x
Old	Old English	ceapian	ciepemann	x
Official	Polish	kupić	kupiec	x
Official	Portuguese	comprar	comerciante	x
Official	Romanian	cumpăra	negustor	
Non-EU	Russian	купить	купец	x
Semi-official	Scottish Gaelic	ceannaich	ceannaiche	x
Non-EU	Serbian	купити	N/A	
Official	Slovak	kúpiť	kupec	x
Official	Slovenian	Kupi	trgovec	
Official	Spanish	Compra	comerciante	
Official	Swedish	köpa	köpman	x
Non-EU	Turkish	Satın	ticaret	
Non-EU	Ukrainian	купити	N/A	
Semi-official	Welsh	prynu	groser	