Lecture 3
Wednesday, September 13

THE MARKET: THEORY & PRACTICE
I. HOW IT IS SUPPOSED TO WORK

ANNOUNCEMENT

Film #1 (note: change of film) next week

The Corporation

room 3650 Humanities Building
7:00 p.m., Tuesday, September 19
7:00 p.m., Wednesday, September 20

Course website:
http://www.ssc.wisc.edu/~wright/Sociology-125-2006.htm

I. THE OVERALL ARGUMENT ABOUT CAPITALISM & MARKETS

Markets are a desirable feature of any complex economy for two basic reasons:

1) Markets contribute in significant ways to efficiency, and

2) Market exchanges do positively affect individual freedom.

However:

3) The unregulated free market with minimal government intervention is very unlikely to perform optimally and, in a variety of important ways, actually ends up deeply limiting individual freedom.

Conclusion:

4) What we need are *democratically accountable market institutions*.

II. WHAT IS CAPITALISM? Some Basic Definitions

1. Exchange: Production is not for immediate used, but to sell things to other people

2. Commodities: The things you produce for exchange

Commodification = Extension of the market into spheres previously not governed by exchange

***De*commodification =** Retreat from market provision

3. Market: the social process through which these exchanges of commodities take place.

4. Capitalism: Capitalism is not just a free market society; it is a market society with two other critical elements:

(i) The means of production are owned privately, not by the state or by communities

(ii) The labor that is used in production is obtained through voluntary market exchange: the labor market.

III. TWO PRIMARY ARGUMENTS IN DEFENSE OF CAPITALIST MARKETS

1. MORAL ARGUMENT:
capitalist markets promote freedom = *negative freedom*

2. PRAGMATIC ARGUMENT:
capitalist markets promotes efficiency

Adam Smith Quote
about the “invisible hand”

An individual who “intends only his own gain” is “led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectively than when he really intends to promote it.”

III.3 The Technical idea of Market efficiency: *Pareto Optimality*

***Optimality* = the best possible outcome of a process**

***Pareto Optimality* = a distribution of things such that no one can be made better off without someone becoming worse off.**

Pareto *suboptimality* = a situation in which by redistributing things at least one person could be made better off without anyone becoming worse off.

***Basic claim about markets*: free markets generate Pareto optimality of distributions of things exchanged on the market**

III.4 Three Kinds of Efficiency in Markets

1. **Allocative Efficiency**: the distribution of things is "Pareto optimal"
2. **Dynamic Efficiency**: optimal innovation, risk taking and growth
3. **Macro-economic Efficiency**: smooth running of the system – low inflation, low unemployment

IV. The Market & Limited Government

According to strong defenders of capitalist free markets:	
Things the state should do	**Things the state should NOT do**
• Law and order and national defense • enforce contracts • prevent "negative externalities" • provide the most important "public goods" (streets, sanitation)	• help the poor through income support • subsidize higher education • Provide health care • Provide training for unemployed workers • prevent global warming