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Why the Market Subverts Democracy

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Proponents of neoliberalism contend that promoting free markets is nearly synonymous with promoting democracy. Even those who reject extreme neoliberalism and call for regulating markets often express reluctance to do so because such interventions, in their view, diminish economic freedom to some extent. After a critical examination of competing definitions of economic democracy, this article argues that, contrary to popular opinion, the market system undermines both economic and political democracy in a number of ways.

Keywords: *markets; economic democracy; economic freedom; self-management; externalities*

As the 20th century came to a close, the free market jubilee was in full swing. The demise of central planning in Communist countries cast a pall over any talk of governmentally led planning of how best to use society's productive resources. In the 1980s, Margaret Thatcher and Helmut Kohl defeated social democracy in Europe and Ronald Reagan put liberals on the run in the United States. In the 1990s when social democrats regained power in Germany and Great Britain and Democrats in America won back the White House, instead of reining in market mania, Tony Blair, Gerhard Schroeder, and Bill Clinton defeated more progressive forces inside their own parties, promoted pro-market, third-way domestic policies, and directed the International Monetary Fund, World Trade Organization, and World Bank to force free market medicine down the throat of one Third World country after another. In the aftermath of the East Asian financial crisis, even mighty Japan and other Asian "tigers" such as South Korea were forced to bow to the market gods they had long held at bay and abandon their highly successful "Asian model" of international economic planning. By century's end, free market mania had silenced critics in both conservative and liberal political circles and neoliberalism reigned supreme in both international and domestic economic policy. Consequently, to speak ill of markets only narrowed access to ears, and even the most progressive economists quickly learned how to reformulate policy proposals as suggestions about improving market performance.

I am one of a few professional economists who maintained that there is no place for markets in a truly desirable economy. I have made the case against markets on equity grounds, explaining why labor and capital markets inevitably reward people

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unfairly and why I believe it is naive to think that significant redistributive correctives can be won and defended as long as the market system persists (Hahnel, 2005a). I have made the case against markets on efficiency grounds, arguing that contrary to professional and popular opinion, there is every reason to believe that markets allocate resources very inefficiently (Hahnel, 2007; Hahnel & Albert, 1990). And in a number of publications spanning 15 years, I have described and defended an alternative allocative mechanism called "participatory planning" that I believe is superior to markets on both efficiency and equity grounds, arguing that, contrary to what skeptics claim, there *is* a viable alternative to markets other than authoritarian planning (Albert & Hahnel, 1991a, 1991b, 1992a, 1992b, 2002; Hahnel, 2000, 2005b). This article explores the relationship between the free market system and democracy. Proponents of neoliberalism contend that promoting the free market system is nearly synonymous with promoting democracy. This article argues that expansion of the free market system undermines both economic and political democracy.

Linking Free Markets to Democracy: The First Slight of Hand

The centerpiece of the ideological defense of the free market system is the concept of economic freedom. Supporters equate economic democracy with economic freedom and claim that only the free market system can provide economic freedom. Substituting the flawed concept of economic freedom for a more meaningful definition of economic democracy plays on the obvious truth that it is good when people are free to do what they want. But what are we to do when the freedom of one person to do what he or she wants infringes on the freedom of others to do as they wish? Uncovering the concerns that arise when economic freedom is substituted for the principle that people should control their own economic destinies is the first step toward understanding why the free market system subverts rather than promotes economic democracy.

Milton Friedman (1964) argues in *Capitalism and Freedom* that the greatest virtue of capitalism is that it provides people with economic freedom defined as the freedom to do whatever one wishes with one's person and property—including the right to contract with others over their use of one's person or property.

The first problem with Friedman's concept of economic freedom is that there are important situations in which the economic freedom of one person conflicts with the economic freedom of another person. If polluters are free to pollute, then victims of pollution are not free to live in pollution-free environments. If employers are free to use their productive property as they see fit, then their employees are not free to use their laboring capacities as they see fit. If the wealthy are free to leave their children large bequests, then new generations will not be free to enjoy equal economic opportunities. If those who own banks are free from a government-imposed minimum reserve requirement, ordinary depositors are not free to save safely. So it is not enough simply to shout "let economic freedom ring"—as appealing as that may sound.

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The appeal of the concept of economic freedom rests largely on a presumption that when one person exercises his or her economic freedom, that individual does not infringe on the economic freedom of others. It has often been remarked that in the world that John Locke envisioned, everyone had sufficient wherewithal to produce whatever he or she wanted and nobody's choices limited the choices open to anyone else. In this context, the goal of increasing everyone's decision-making discretion over more elements in his or her individual choice set was both noncontradictory and attractive. But it was only Locke's imagination and the implicit assumptions of classical liberalism that armed everyone with sufficient wherewithal to pursue their goals and assured us that none could make choices that limited the choices open to others. Whether people were ever so armed and immune to the choices made by others is highly questionable. Certainly in today's world where the natural environment is no longer bounteous relative to the human population and where large corporations not only own the preponderance of the means of production but have patented the most productive technologies as well, it should be painfully obvious that the options for most of us are largely determined by choices made by others.

In any case, when there are conflicts between people's economic freedoms in free market systems, whose economic freedom takes priority is settled by the property rights system. Once we realize that economic freedom is meaningless without a specification of property rights—that it is the property rights system that dictates who gets to decide when conflicts inevitably arise—the focus of attention shifts to where it should have been in the first place: How does a particular property rights system distribute decision-making authority in a free market economy? Does a property rights system distribute control over economic decisions in a way we would consider democratic? Or by distributing property unequally and by giving priority to some categories of property rights over others, does a particular property rights system leave most people little control over their economic destinies and award a few control over the economic fates of the many? The first problem with Milton Freidman's way of conceptualizing the notion that people should control their own economic lives is that it merely begs the question and defers all problems to an unspecified property rights system.

The second problem is that although Friedman and other champions of the free market system wax poetic on the subject of economic freedom, they have remarkably little to say about what is a better or worse property rights system. Most of what little they do say reduces to two observations: (a) whatever the distribution of property rights, it is crucial that property rights be clear cut and complete, because otherwise there will be inefficiency due to "property right ambiguity"; and (b) because it is difficult in their view to argue on theoretical grounds that any distribution of property rights is preferable to any other, there is no reason to change the distribution of property rights history bequeathed us. If one can prove that property was acquired in clear violation of the law, Friedman and his followers are willing to

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consider redress. But they refuse even to consider the possibility of “legal theft”—that is, a lawful distribution of property rights that effectively disenfranchises whole categories of economic actors. In sum, Friedman makes no objection when his fellow conservatives defend the property rights status quo and considers only clarification of ambiguities a legitimate area for public policy. What is entirely lacking is any attempt to develop criteria for better and worse distributions of property rights. The silence from conservative theoreticians is deafening on this point, and it is hardly surprising when those favored by existing property rights regimes fail to complain about the oversight.

Conservatives are not the only proponents of conceptualizing economic democracy as economic freedom. Over the past three decades, Amartya Sen (1999) has arguably done more to challenge the dogma that there is no remedy for poverty than any other living economist. However, his latest work illustrates the dangers that liberals court when they embrace the economic freedom metaphor. In *Development as Freedom*, Sen goes beyond his earlier interpretation of economic development as the expansion of people’s “capabilities” and argues that development can be defined as the expansion of freedom. But when we conflate all goods into one—freedom—we not only reduce the power of language but we also risk deceiving ourselves that something is simpler than it really is—a mistake Sen himself has correctly warned others against time and time again in other contexts. Economic development is *not* simply the expansion of freedoms. More generally, we have multiple economic goals—economic democracy, economic justice, environmental sustainability, and economic efficiency, to name four—which we should not reduce to a single goal—economic freedom. Moreover, it is no less ambiguous and problematic when Amartya Sen says the goal of economic development is to maximize people’s freedom than when Milton Friedman says the most important economic goal is to maximize economic freedom. What are we to do when people’s freedoms conflict? Friedman’s supporters are happy to leave the answer to the reigning property rights system. Anyone who is familiar with Sen’s work knows that he is not willing to let the reigning system of property rights be the arbiter of some freedoms over others and the freedoms of some people over the freedoms of other people. But if existing property rights regimes disenfranchise the have-nots, what property rights deliver economic democracy? How does one argue for the superiority of one property rights regime over another? Just as conservatives sidestep this question by favoring existing property rights regimes, Sen sidesteps the basic philosophical question by simply calling for an expansion of property rights for the poor. In a world in which property rights govern decision-making power and life prospects, favoring an expansion of property rights for those with little or none is good politics. But it is hardly a theoretical justification for a particular pattern of property rights as a means to achieve economic democracy. Neither conservatives nor Sen makes a compelling theoretical case for the property rights they favor. In effect, they each assume their conclusion.

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Reconceptualizing Economic Democracy

If economic freedom is an inadequate and misleading conception of economic democracy, what are the alternatives? The other dominant conception of economic democracy is majority rule. This concept was borrowed from political science, where the notion that no citizen should have more say over political matters than any other was enshrined in the doctrine of "one person one vote." The problem with majority rule is simple: When a decision has a greater affect on some people than others, by giving each person an equal vote, those more affected by a decision can find themselves overruled by those who are less affected. Even in the political sphere of social life, where there are many decisions that do affect all citizens more or less equally, there are some political decisions that clearly affect the lives of some citizens more than the lives of others, and some choices individuals should be allowed to make regardless of how much others may disagree and claim to be affected. In these circumstances, political scientists sensibly amend the principle of majority rule with other concepts such as a bill of rights and supermajority voting rules.[1] But in the case of economic decisions, the probability of unequal effects is much greater than in the case of political decisions. Although there are some economic decisions that affect only a single person and there are some economic decisions that affect us all to roughly the same extent, most economic decisions affect more than one person but affect some people a great deal more than others. And therein lies the rub. Although the concept of economic freedom works well for economic decisions that only affect one person and the concept of majority rule works well for economic decisions that affect us all equally, neither conception of economic democracy works well for the overwhelming majority of economic decisions that affect some of us more than others.

An alternative conception of economic democracy that takes into account the fact that most economic decisions affect more than one person but not everyone equally is quite straightforward: Consider economic democracy as having decision-making input or power in proportion to the extent that you are affected by a choice or decision. If you are affected more than someone else by a particular decision, then you would have more say than they do. If you are affected less, you would have less input than they do. Then we can say that if everyone has decision-making input in proportion to the degree they are affected, for every economic decision, the economy is characterized by or has achieved economic democracy. However, the phrase "economic democracy" is already used to mean different things by different people and is practically never used in the way suggested here. So it seems helpful to give this new way of thinking about economic democracy a name of its own. I have suggested defining *economic self-management* as decision-making input in proportion to the degree one is affected by different economic choices. I have also argued that thinking about achieving economic self-management for everyone is the best way to think about achieving economic democracy (Hahnel, 2005a).

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Whitt (1979) as well as Rothschild and Leach (2006) note in their studies of groups seeking to refine the practice of democratic self-rule that people at the grass roots have often recognized that those affected more by a decision should have more power over that decision. In which case, what is novel about the definition of self-management I propose is only the notion that decision-making power should be proportionate to the degree that a person is affected. However, because our ability to measure how much more some are affected than others in most situations would be, in my opinion, imperfect in any case, it is not clear that what I propose is different in practice from procedures developed by groups studied by Rothschild and Leach (2006) and Iannello (1992). In any case, just because it may never be possible to arrange for decisions to be made in ways that every person enjoys perfect economic self-management—just as it may be impossible ever to achieve perfect economic justice—does not mean it is of no use to have a precise definition of the goal we seek, no matter how elusive it may prove to be.

At least the goal of maximizing economic self-management, as defined above, is always meaningful, whereas the goal of maximizing people's economic freedom over the choice sets that affect them is only meaningful in a context where individual choice sets never intersect. When choice sets do intersect, increasing the economic freedom of one person over his or her choice set necessarily diminishes the economic freedom of someone else over the choice set that affects him or her. In other words, when choice sets intersect, it is impossible to simultaneously maximize the economic freedom of both, which means that one cannot maximize economic freedom in general. But regardless of how intertwined the choice sets that affect people may be, no matter how often an economic decision affects more than one person, no matter how uneven the pattern of effects of economic decisions on multiple parties, it is still always possible in theory to move from a decision-making procedure that less perfectly apportions decision-making input in accord with the extent to which people are affected to a decision-making procedure that more perfectly apportions decision-making power according to how much people are affected.

Of course, agreeing on a definition and a goal is not the same as achieving the goal. Just because we have a clear definition of economic self-management does not mean we know how to determine the degree to which different people are affected by different economic decisions. Nor does it mean that we know what procedures will best achieve economic self-management. Nor does it help us identify and deal with situations in which it is pointless to deny that people do feel affected by the behavior of others, but we may not think it is right to give them input in any case. In other words, having a clear idea of what we mean by economic democracy does not solve any of the hard problems of achieving it. But getting clear about the goal is a first step in the right direction. As long as the phrase "economic democracy" remains vague and is used to mean different things by different people, it is difficult to make progress toward achieving it. And as long as people labor under a misconception about what economic democracy means, we will continue to search in the wrong directions.

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Why Free Enterprise Undermines Economic Democracy

Disagreements over how best to define economic democracy aside, Friedman's (1964) argument that the free enterprise system allows people to control their economic lives is misleading and unpersuasive. According to Friedman, there is no conflict between the economic freedoms of employees and employers as long as employment contracts are agreed to by both parties under competitive conditions. As long as the employment relation is voluntary, and as long as labor markets are competitive so that nobody is compelled to work for a particular employer or compelled to hire a particular employee, the economic freedoms of all are preserved according to Friedman. In this view, when an employee agrees to work for an employer, that individual is merely exercising his or her economic freedom to do with personal laboring capacities as he or she sees fit. The employee could use the human capital himself or herself if so wished, but if offered what is considered to be a better deal, that employee should be free to relinquish the right to use his or her laboring capacities to another for a wage payment that he or she finds suitable. What is more, if the employee were prohibited from making this choice, the individual's economic freedom would be violated, just as the economic freedom of the employer to use his or her productive property as seen fit would be violated if he or she were barred from hiring employees to work with the property under his or her direction. Accordingly, Friedman concludes that union shops are violations of employee as well as employer economic freedom and that the socialist ban on private enterprise altogether is the ultimate violation of people's economic freedom to hire and be hired by one another, should they so choose.

The first problem with this defense of free enterprise as the cornerstone of economic freedom is that not all people have, or could ever have, an equal opportunity to become employers rather than employees. In real capitalist economies, a few will become employers, the vast majority will work for someone else, and some will be self-employed. Moreover, who will be employers, employees, or self-employed is determined for the most part neither randomly nor by people's relative preferences for self-managed versus other-directed work. Simple models reveal that only under egalitarian distributions of capital would relative preferences for self-managed work determine who become employers and who become employees. Under inegalitarian distributions, those with more capital inevitably become the employers, while those with less capital become the employees—irrespective of people's relative preferences for self-management or aversions to being bossed around (Hahnel, 2002, 2006; Roemer, 1984). One of the most profound insights provided by these simple models is that although it is true, in a sense, that employees "choose" to permit their employers to tell them what and how to produce, they do not necessarily do so because they have a weaker desire for self-management than those they go to work for. The distribution of wealth tilts the playing field so that some will benefit more by becoming employers and others will benefit more by becoming employees independent of work preferences for self-management.

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Defenders of free enterprise answer this criticism by arguing that anyone who wants to work badly enough for himself or herself can borrow whatever is necessary to become self-employed or to become an employer. They go on to point out that assuming perfect credit markets, anyone who can run an efficient business can borrow enough to do so and thereby avoid having to play the role of an employee. But this line of reasoning assumes more than any real capitalism can offer—credit on equal terms for all—and ignores the fact that even competitive credit markets can impose a steep price on the poor for self-management that the wealthy are not required to pay. In a world with uncertainty and imperfect information—not to speak of patents and technological and financial economies of scale—those with more collateral and credentials will receive credit on preferential terms, while the rest of us will be subject to credit rationing in one form or another. To expect any different is to expect lenders to be fools. So being referred to the credit market is not going to even the playing field for the poor. But even if all did receive credit on equal terms, the simple models I referred to above, which assume that anyone can borrow as much as he or she wants at the market rate of interest and nobody has access to credit for less, demonstrate that those who avoid the status of employer by borrowing in credit markets in effect pay their wealthy creditors for a right that should be as inalienable as the right to vote on political issues. There is a bottom line, and the buck must stop somewhere: Those without wealth to begin with would face an uphill road to avoid employee status, even if credit markets were perfect, and they face a much steeper uphill road when credit markets are less than perfect, which they always are.

The second problem is there is good reason to believe that employers will not necessarily organize work in accord with workers' preferences as the mainstream theory of "producer sovereignty" claims that they will, provided that labor markets are competitive. Over the past 30 years, radical political economists have elaborated a "conflict theory of the firm," which spells out why profit maximization requires capitalists to organize work in ways that disempower their employees. The argument goes as follows: There is an inherent conflict of interest between employers and employees over how high or low the wage rate will be and how much effort employees will exert for their wages. It would be irrational for employers to only consider the impact of how they decide to organize the work process on productivity when their choices will also affect their employee's bargaining power, which will in turn affect how much employees must be paid and how hard they will work. In other words, because profits depend not only on the size of net output (i.e., productivity) but also on how the net output is divided between wages and profits, rational employers will consider how the organization of work affects both. For example, consider an automobile maker's choice between assembly line and work team technologies. Suppose when quality and reliability are taken into account, making automobiles in work teams is more productive than making cars on an assembly line, and suppose that employees enjoy working in teams more than working on assembly lines as well. But also suppose that team

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production is more skill enhancing and builds employee solidarity, whereas assembly line production reduces the knowledge component of work for most employees and reduces employee solidarity by isolating employees from one another. If the bargaining power effect outweighs the productivity and job enjoyment effect, competition for profits will drive auto makers to opt for assembly-line production, even though it is less efficient and workers find it less pleasant as well. When one realizes that employers must consider the effects of work organization on their employees' bargaining power, the conclusion that employers will dutifully organize work to their employees' satisfaction falls by the wayside.

The final problem with the argument that capitalism promotes economic freedom is that even if the capitalist playing field was even and the probability of becoming an employer rather than an employee was the same for everyone regardless of wealth, this would not mean that the employer–employee relationship was a desirable one. Of course, random assignment would be far better than having relative wealth determine who will be boss and who will be bossed. But is it better than having neither bosses nor being bossed? That is, is it better than an economy in which all enjoy self-management? Consider this analogy: A slave system in which Blacks apply to be slaves for White slave masters of their choice is better than one where White slave owners trade Black slaves among themselves. A slave system in which people are assigned randomly to be slaves or slave masters is better than one in which only Blacks can be slaves and only Whites can be slave owners. But abolition of slavery is better than even the least objectionable kind of slavery. The same holds for wage slavery. A labor market in which the poor are free to apply to work for employers of their choice is better than one in which wealthy employers trade poor employees among themselves—as major league baseball players have discovered. A system in which who become employers and who become employees is truly a random walk is better than one in which the wealthy predictably become the employers and the poor predictably become their employees. But abolition of wage slavery—replacing the roles of employer and employee with self-management for all—is better than even the least objectionable system of private enterprise.

Why Markets Undermine Economic Democracy

If the claim that free enterprise is a bulwark of economic freedom holds little water on careful examination, what of the argument that markets promote economic freedom? In one of his most quoted passages, Milton Friedman (1964) argues that the principal virtue of competitive markets is that they are uniquely compatible with economic freedom:

> The basic problem of social organization is how to coordinate the economic activities of large numbers of people. The challenge to the believer in liberty is to reconcile this

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> widespread interdependence with individual freedom. Fundamentally there are only two ways of coordinating the economic activities of millions. One is central direction involving the use of coercion—the technique of the army and of the modern totalitarian state. The other is voluntary cooperation of individuals—the technique of the market place. The possibility of coordination through voluntary cooperation rests on the elementary, yet frequently denied, proposition that both parties to an economic transaction benefit from it, *provided the transaction is bilaterally voluntary and informed*. (p. 12)

The first problem with this argument is it is not "one person one vote" but "one dollar one vote" in the marketplace. Some claim this as a virtue: If I have a particularly strong preference for a good, I can cast more dollar ballots to reflect the intensity of my desire. But this argument conflates two issues. There is nothing wrong with a system of social choice that permits people to express the intensity of their desires. In fact, this is necessary if we are to achieve self-managed decision making. But there is something wrong when people have vastly different numbers of dollar ballots to cast in market elections. Few would describe a political election in which some were permitted to vote thousands of times and others were permitted to vote only once as a system to be admired and emulated. But this is exactly the kind of democracy that markets provide. Those with more income have a greater impact on what suppliers in markets will be signaled to provide than those with less income, which explains why market freedom often leads to outcomes that we know do not reflect what most people need or want. Why are there so many plastic surgeons in Hollywood, when many poor, rural communities suffer for lack of basic family practitioners? How can the demand for cosmetic surgery in Hollywood be so high and the demand for basic health care in poor, rural communities be so low? There are many more rural poor who vote in the health care market for basic health care than there are wealthy Hollywood residents who vote for plastic surgery. And arguably the intensity of poor people's desires for basic health care is higher than the intensity of Hollywood residents' desires for plastic surgery as well. But those voting for plastic surgery in Hollywood have many more votes to cast for even their less pressing desires than the poor have to cast for life and death needs. Hence, ample provision of medical services of marginal benefit—such as plastic surgery in Hollywood and failure to provide essential medical services for the rural poor—when health care decisions are left to the marketplace.

The second problem is that Friedman's portrayal of market exchanges as noncoercive ignores the critical importance of what those who confront each other in the marketplace arrive at. When some arrive at the labor market with more capital than others, it is entirely predictable that those with more capital will end up being the employers and those with less their employees. Moreover, as long as capital is scarce, it is predictable that employers will capture the lion's share of the efficiency gain from the labor exchange, which puts employees to work with more capital than they would otherwise have been able to work with. Similarly, those who arrive at the

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credit market with more capital will lend to those with less, and as long as capital is scarce, the lenders will capture the lion's share of the increase in the borrower's productivity that results. Friedman can call these outcomes "noncoercive" on grounds that those without capital volunteered to exchange their laboring capacities for a wage and borrowers agreed to pay interest knowing full well what the consequences would be. But this merely displaces the source of coercion. It is their lack of capital in the first place that "coerces" employees and borrowers to "volunteer" to be fleeced. Are we to believe they would have volunteered to be the ones who showed up at the labor or credit market with less capital in the first place?

The third problem with Friedman's assertion that market decisions are free from coercion is that buyers and sellers often come to agreements with adverse consequences for third parties who have no say in the matter whatsoever. Friedman acknowledges that victims of what he labels "neighborhood effects" are coerced but presumes that these are minor inconveniences that seldom occur. However, a growing percentage of nonmainstream economists are becoming convinced that what most economists call "external effects" may prove to be the rule rather than the exception, thereby leaving many disenfranchised and coerced "external parties" when buyers and sellers make decisions that affect them. Why are externalities likely to be pervasive? Increasing the value of goods and services produced and decreasing the unpleasantness of what we have to do to produce them are ways by which producers can increase their profits in a market economy, and competitive pressures will drive producers to do both. But maneuvering to appropriate a greater share of the goods and services produced by externalizing costs onto others and internalizing benefits without compensation are also ways to increase profits. Moreover, competitive pressures will drive producers to pursue this route to greater profitability just as assiduously. Of course, the problem is, although the first kind of behavior serves the social interest as well as the private interests of producers, the second kind of behavior serves the private interests of producers at the expense of the social interest. The positive side of market incentives has received great attention and praise, dating back to Adam Smith who coined the term "invisible hand" to describe it. The darker side of market incentives has been relatively neglected and grossly underestimated. Two exceptions are d'Arge and Hunt (1971; also see Hunt, 1980; Hunt & d'Arge, 1973), who coined the less famous but equally appropriate term "invisible foot" to describe the socially counterproductive behavior markets drive participants to engage in.

Market enthusiasts seldom ask, "Where are firms most likely to find the easiest opportunities to expand their profits? How easy is it usually to increase the size or quality of the economic 'pie'? How easy is it to reduce the time or discomfort it takes to 'bake' it? Alternatively, how easy is it to enlarge one's slice of the pie by externalizing a cost or by appropriating a benefit without payment?" Why should we assume that in market economies it is infinitely easier to expand private benefits through socially productive behavior than through socially counterproductive behavior? Yet this

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implicit assumption is what lies behind the view of markets as guided by a beneficent invisible hand rather than a malevolent invisible foot.

Market admirers fail to notice that the same feature of market exchanges primarily responsible for small transaction costs—excluding all affected parties but the buyer and seller from the transaction—is also a major source of potential gain for the buyer and seller. When the buyer and seller of an automobile strike their convenient deal, the size of the benefit they have to divide between them is greatly enlarged by externalizing the costs onto others of the acid rain produced by car production and the costs of urban smog, noise pollution, traffic congestion, and greenhouse gas emissions caused by car consumption. Those who pay for these costs and thereby enlarge car maker profits and car buyer benefits are easy marks for car sellers and buyers for two reasons: They are geographically and chronologically dispersed and the magnitude of the effect on each negatively affected external party is small yet not equal. Consequently, external parties individually have little incentive to insist on being party to the transaction—the external effect on a single party is seldom large enough to make it worthwhile for one person to try to insert himself or herself into the negotiations. But there are formidable obstacles to forming a coalition to represent the collective interests of all external parties. Organizing a large number of individuals who may be geographically and chronologically dispersed—when each has little but different amounts at stake—is a difficult task. Who will bear the transaction costs of approaching members when each has little to benefit? When approached, who will report truthfully how much they are affected when—depending on who has the property right—it is to their advantage to either overexaggerate or underexaggerate? Although markets minimize the transaction costs for people to act as individual buyers and sellers, they do nothing to reduce the transaction costs for people to express their preferences jointly or collectively. As a result, decisions that affect many are made by only a few in market systems, and although the buyer and seller may be those who are most affected, there is no reason to believe that the combined interests of all the external parties that are disenfranchised is not large compared to the interests of the buyer and seller.

A sufficient condition for buyers and sellers to have the opportunity to profit in socially counterproductive ways by shifting costs onto others is that each one of us has diffuse interests that make us affected external parties to many exchanges in which we are neither buyer nor seller. Even if we could make every market perfectly competitive and thereby eliminate any power imbalance between buyers and sellers, external parties will be disenfranchised and outcomes will be inefficient, because the interests of the disenfranchised will not be accounted for. Economists focus almost exclusively on inefficiencies that result when effects on external parties go ignored in the market decision-making process and debate how prevalent and significant those inefficiencies are likely to be. But when buyers and sellers decide what will be produced and consumed through their market transactions, they also subvert economic democracy by disenfranchising all who are external parties. By definition,

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external parties to market transactions do not affect economic decisions in proportion to the degree they are affected, which means that externalities violate economic self-management as well as generate economic inefficiencies. Moreover, if there are good reasons to believe external effects will be prevalent in market systems because buyers and sellers can often profit from externalizing costs on others as easily as they can profit by benefiting others, these violations of economic democracy that lead to inefficiencies will be widespread.

The final problem is that Friedman assumes his conclusion when he asserts that the only ways to coordinate the activities of millions are via markets or coercion—"the technique of the army and of the modern totalitarian state." He dismisses the possibility of any kind of democratic planning, without bothering to provide any argument whatsoever.

Free Market Systems in the Real World

Up to this point, this article has treated the relationship between the free market system and economic democracy on a purely theoretical level. Moreover, I have considered matters assuming that all markets are perfectly competitive. I think that this is a useful exercise, because it is important to know if free market economies fail to promote economic democracy due to something intrinsic to their nature or only because real-world markets deviate from ideal models. But this approach is unlikely to provide a realistic sense of how much recent expansions of the free market system have undermined economic democracy. In truth, confusing the cause of free markets with the cause of democracy is astounding, given the overwhelming empirical evidence that the latest free market jubilee has disenfranchised ever larger segments of the world body politic. It would require a different article to outline the empirical case, but it is obvious that the cause of economic democracy is not being served when 30-year-old MBA employees of multinational financial companies trading foreign currencies, bonds, stocks, and derivatives in their New York and London offices affect the economic livelihoods of billions of ordinary people who toil in Third World economies more than their own elected political leaders can.

The simple fact is that the more powerful people generally benefit more than the less powerful people from market exchanges—which means that the expansion of the market system predictably leads to growing disparities of wealth and economic power. Mainstream economists concede that more powerful parties gain more when markets are noncompetitive. But when those who are more wealthy trade with those who are less so, there is every reason to expect that the wealthier party will benefit more from the exchange than the poorer party, even if the market is competitive (Hahnel, 1999, 2002, 2006); this means that economic liberalization breeds concentration of wealth and power, regardless of how competitive markets may be. Those who deceive themselves (and others) that markets nurture democracy ignore the

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simple truth that markets tend to aggravate disparities in wealth and therefore economic power and focus instead on less important effects. It is true that the spread of markets can disempower traditional elites. But this does not imply that markets will cause wealth and power to be more equally dispersed and democracy to be enhanced. If old obstacles to economic democracy are being replaced by new, more powerful obstacles in the persons of CEOs of multinational corporations and multinational banks, the managers of hedge funds, the new global mandarins at the World Bank and International Monetary Fund, and the chairs of adjudication commissions for the North American Free Trade Agreement and the World Trade Organization, and if these new elites are more effectively insulated from popular pressure than their predecessors, it is not the cause of democracy that is served.

Why the Free Market System Undermines Political Democracy

Milton Friedman (1964) claims that besides providing economic freedom, the free market system promotes political freedom as well. His first argument is that in a free enterprise economy, people have a choice of nongovernment employers. Friedman points out that this means people are not reliant on the government for their economic livelihood and therefore will feel free to oppose government policies. Friedman's second argument is that if wealth were distributed equally, none would have sufficient discretionary wealth to fund political causes. Because wealth is distributed very unequally in free market economies, Friedman concludes that there are always multiple funding sources available for all political causes.

Economic democracy *is* political democracy's best friend, and authoritarian economies *are* political democracy's worst enemy. But this does not mean free market systems promote political freedom and democracy. One problem with Friedman's first argument is that private employers can intimidate employees who are afraid to lose their jobs, just as a government employer can. In other words, Friedman is blind to the dictatorship of the employer and sees government as the only conceivable source of coercion. A more important fallacy with his first argument is that a monolithic state employer is not the only alternative to a wealthy private employer. State monopoly of employment opportunities in Soviet style economies was a serious obstacle to freedom of political expression in those societies. But in employee-managed market socialist economies and in the kind of participatory economy I advocate, there are multiple employers to choose from and no restrictions on leaving one employer to work for another. The state exerts no influence over who gets hired or fired in enterprises in either of these kinds of economies.

The obvious problem with Friedman's second argument—that unequal wealth provides alternative sources of funding for political causes—is that by his own admission, those with vastly greater wealth will control access to the means of political expression. This effectively disenfranchises the poor who have no recourse but

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to appeal to the wealthy to finance their political causes. Jerry Brown was right when he argued in the 1992 Democratic Party presidential primaries that politicians in both major parties are essentially bought and paid for by wealthy financial interests whose contributions are critical for TV ads that determine success in a daunting gauntlet of state primaries. Ralph Nader was right when he argued during the 2000 general election that both the Republican and Democratic parties had been effectively bought by corporations and should be seen for what they are, two wings of a single business party, the Republicrats. Every viable politician in America has to ask how his or her stand on an issue will affect both voter appeal and funding appeal—with the effect on donations from wealthy contributors becoming increasingly more vital to electability. The fact that Ross Perot and Steve Forbes Jr. could gain serious public consideration for their rather harebrained political ideas by financing presidential bids out of their own deep pockets, whereas 99% of the population cannot afford a moderate sized ad in the *New York Times*, much less fund a serious political campaign for any level of office, is hardly evidence that the free market system makes it possible for all political opinions to get a hearing. The fact that pundits considered Senator John Kerry the front runner for the Democratic Party presidential nomination in 2004 long before the first primary in no small part because he is married to an heiress who announced that her entire family fortune was available to her husband for his campaign demonstrates that money obstructs equal political opportunities for all, not that it promotes political democracy. And the rare cases in which grassroots activism and true voter appeal win out in a phase of the political process—such as the McGovern primary campaign in 1972 and the early stage of the Dean campaign in 2004—demonstrate how much money usually distorts political democracy, not that the system is free from bias.

Moreover, why does Milton Friedman think that the wealthy will finance political causes aimed at reducing their wealth and power? At best, the wealthy in private enterprise economies whom Friedman paints as "patrons of the political arts" would predictably provide more adequate funding for some schools of "political art" than others. Simply put, Friedman's attempt to make a political virtue out of the unequal economic power that increasingly characterizes free market economies is absurd. Unequal economic power breeds unequal political power, not political democracy, as any school child knows.

Finally, markets undermine the kinds of human traits critical to democracy. As Samuel Bowles (1991) explains:

> If democratic governance is a value, it seems reasonable to favor institutions that foster the development of people likely to support democratic institutions and able to function effectively in a democratic environment. Among the traits most students of the subject consider essential are the ability to process and communicate complex information, to make collective decisions and the capacity to feel empathy and solidarity with others. As we have seen, markets may provide a hostile environment for the cultivation of these traits. Feelings of solidarity are more likely to flourish where economic relationships are

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ongoing and personal, rather than fleeting and anonymous; and where a concern for the needs of others is an integral part of the institutions governing economic life. The complex decision-making and information processing skills required of the modern democratic citizen are not likely to be fostered in markets. (p. 16)

A Final Observation

It is too early to know if the free market tide has crested. Opposition to neoliberal globalization has certainly increased in some places, most noticeably Latin America, and there is evidence that nostalgia for social democratic domestic programs may be on the rise in Europe and perhaps in the United States as well. However, even those who speak out against extreme neoliberalism seem prone to believe that markets facilitate democracy. I suspect this belief stems, at least in part, from the dominant interpretation of modern European history in which the simultaneous spread of the market system and political democracy is assumed to be in large part because the former caused the latter.

It is hardly surprising that perhaps the most socially intrusive institution in human history should have disrupted old, precapitalist obstacles to democratic rule. The question, however, is not whether markets undermined old structures of domination—which they clearly did—but if the new patterns of economic power that the market system creates are supportive or detrimental to democratic aspirations. I am skeptical that markets deserve nearly as much credit as mainstream interpretations award them for the emergence of European political democracy. I suspect that this interpretation robs Europeans who fought against the rule of monarchs and feudal lords in the 17th, 18th, and 19th centuries; Europeans who fought for universal popular suffrage in the 19th and 20th centuries; and Europeans who fought against fascist and communist totalitarianism in the 20th century of much of the credit they deserve. However, a worthy rebuttal to the thesis that we owe whatever advances democracy has made in Europe to the rise of the market system there would take me too far afield and require more historical knowledge than I pretend to have.

Note

1. Two feminist authors who explored remedies beyond those traditionally considered by political scientists for the problem that decisions often affect some people more than others are Kathleen Ferguson (1984) and Kathleen Ianello (1992).

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