

The Illusion of Free Markets: Punishment and the Myth of Natural Order

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Author: Harcourt, Bernard E.

Reviewer: D'Amico, Daniel J.

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Reviewed for EH.Net by Daniel J. D'Amico, Department of Economics, Loyola University (New Orleans).

The Illusion of Free Markets is a fascinating attempt to understand public policy. There are both effective and ineffective responses to social problems. Human welfare requires interpreting complex social phenomena and affecting social change. To be fooled by an illusion is to be guided by a bad map.

Neoclassical models of political economy distinguish between markets and governments. Markets are presumed efficient when producing and allocating resources, but in some institutional environments, where property rights are poorly defined and information asymmetric, said to fail. Governments are presumed necessary and sufficient to solve market failures. Society suffers when either problem is misdiagnosed and/or either solution incorrectly prescribed. Bernard Harcourt thinks markets have been overrated. Histories of penology and economic thought help correct this.

The market versus government dichotomy dates to the classical school, when economists thought in terms of natural law. Markets were called natural because the price system is self-adjusting and socially coordinative. Neither shortages nor surpluses persist because prices change on the margin. Self-interest guides social welfare "as if by an invisible hand." While economists favor markets because they produce and distribute tangible wealth, Harcourt is concerned that they

under account social costs. In particular, natural law has supposedly borne complex consequences upon American criminal justice.

Markets were heavily regulated during the time of the classical school. Detailed codes of conduct governed all manner of commercial trade. Harcourt observes that Adam Smith and other classicals used the term “policing” to refer to both commercial and criminal regulations. Harcourt prefers Foucault's focus upon discipline over economists' hard dichotomy. Historically, both markets and governments regulated behavior. Both were backed by physical punishments. The market was as disciplinarian as the state.

Harcourt is concerned, and rightly so, with features of American criminal justice. It appears racially biased, excessively severe and uniquely modern. He argues that these are the theoretical consequences of applied natural law. His historical narrative suggests that as the commercial realm was deregulated, disciplinary resources were directed into the penal sphere. Markets were presumed to be self-regulating, which drove a conceptual schism between lawful market behaviors and unnatural criminal actions. Theorists underrecognize the costs of social change invoked by deregulation because they presume the market natural. Today's penal excesses are the presumed result of a growing network of anonymous contracts. Harcourt's message: the notion that markets are free from coercion is an illusion, both yesterday and today. Privatization and deregulation are insufficient policy solutions to mass incarceration.

Harcourt's comments are a welcome update to neoclassical orthodoxy, which has failed to give an explanation or policy reaction to mass incarceration. If one looks -- as Foucault would suggest -- at different enforcement techniques (physical punishment versus torts and fines) used within the different legal spheres (criminal versus civil); or if one looks at the historical specialization of those techniques across those legal spheres, one notices the world is a very different place than it used to be.

Today the market versus government distinction parallels the civil and criminal law. Contract enforcements are maintained by the civil law. Criminal laws are enforced by incarceration. These separate legal spheres were not always distinct, nor were their enforcement resources specialized. Originally there was no criminal law. Physical punishments, such as arrest and jailing, facilitated market exchanges and resolved civil disputes; afterwards a separate criminal law developed. Then physical punishments became more reserved to enforce against crime.

Harcourt argues the doctrine of natural law ushered this process, and led to problematic criminal justice outcomes. Alternatively, Foucault's historical perspective complements an Austrian and Public Choice framework of political economy. Neither markets nor governments should be presumed to resolve each other's failures. The efficient-market hypothesis and traditional public goods theory both risk misguidance by illusion. Enforcement technology is an important focus in so far as it affects the production and distribution of knowledge and incentives.

Austrian political economy emphasizes the distribution of economic knowledge throughout society. Governments differ from markets in how they produce and distribute economic knowledge -- who, what, how, when and where to make and distribute goods. Public Choice political economy emphasizes the incentives that affect rational choice. Bureaucracies produce systematically different incentives than do for-profit markets.

An Austro-Public Choice political economy insists upon the behavioral assumptions applied to governments and markets being symmetrical. Neither market nor government decision-makers are perfectly informed nor perfectly incentivized to accomplish goals. The subsidy and administration of criminal punishments yesterday and today appear not to be an exception.

Harcourt interprets history as a slight against the characterization of commerce as non-coercive. Foucault says markets are disciplinary. Though not emphasized by Harcourt, the inverse also seems true. The history of physical punishments within the market sphere weakens the characterization of governments as particularly necessary for optimal criminal punishment. Presuming criminal punishment a public good may be just as illusionary.

When markets wielded physical punishments they appeared constrained from excess by the self-interests of disputants. Conflicts among traders were self-sorted for profit seekers. Punitive threats made compliance with financial and service court rulings more appealing. Contract violators were inclined to settle and civil plaintiffs sought tangible compensation for loss.

Contemporary criminal justice problems coincide with expanded market economies and decentralized government in the market sphere. An Austro-Public Choice perspective must reference how changes in knowledge and incentives yield such outcomes. On net federal government has grown, as has its role within the criminal justice system in conjunction with mass incarceration's disconcerting results.

Physical punishment has become relegated to the enforcement of criminal law. Though contrary to Harcourt's narrative, driven by the segregationist logic of natural law, this can be seen as

driven by the self-interests of market and government actors. While market traders sought low cost and quantitatively predictable methods to resolve conflict, government capitalized as the monopoly provider of physical enforcements.

Today's greater quantities of physical enforcement are not deployed to enforce civil contracts or tort compliance. Drug and immigration violators occupy most new prison space, unlikely prohibited by contract law. Rather than necessary and sufficient, democracy has proven ineffective to correct the racial, generational, gender, and substance-abuse disproportionality of criminal sentencing. Policy makers have little incentive to change such policies and ordinary citizens lack the necessary knowledge to implement institutional reform.

Daniel J. D'Amico is the author of "The Prison in Economics: Private and Public Incarceration in Ancient Greece," in *Public Choice*. He is currently engaged in a long-term research project focused upon the political economy of mass incarceration.