CHAPTER 5

ASYMMETRIC IDEALIZATION AND THE MARKET PROCESS

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> The evaluation … of the achievements of the free market, turn out again and again to depend on whether the market is being appraised *in* the state of equilibrium, or whether its contributions are being considered in terms of the *systematic process* towards equilibrium of which it consists.
>
> Israel M. Kirzner, "Methodological Individualism, Market Equilibrium, and Market Process"

1. INTRODUCTION

Suppose you are deciding between two locations for your next vacation: Beach and Forest. In trying to decide which to choose, you think about what such trips might be like. You imagine yourself at Beach. It is beautiful and sunny outside as you lie in the sand with a good book, stopping only to dip your toes in the water. Now you imagine yourself at Forest. It is dark and rainy out. You cannot take your planned hikes or fishing excursions; you spend all day pent up in the cabin. After such deliberation, Beach is clearly the right answer for your next trip.

Something has clearly gone wrong here. When imagining your trip to Beach, you assumed it would be bright and sunny outside. Yet when imagining yourself at Forest, you assumed it would be dark and rainy. There, of course, could be good reasons for these assumptions: perhaps Beach typically has good weather forecasts for that time of year whereas Forest does not. But suppose this isn't true; suppose the weather forecasts are typically the same in both locations. If such is the case, then your assumptions about the weather of Beach and Forest are completely unjustified and wrongfully influence your choice. It could be that, under the assumption that it is nice and sunny in both destinations, Forest is a better destination for you than Beach; and under the assumption that it is rainy

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out, Forest still beats Beach. This suggests that Forest is the place for you, contra the decision you actually made.

To avoid choosing the wrong destination, you should either assume that both Beach and Forest will be sunny or that both Beach and Forest will be rainy. In other words, for a meaningful comparison and optimal choice your assumptions about the weather in both destinations should be *symmetrical*. Though this seems like an obvious point, political philosophers often introduce assumptions in their theorizing that are *asymmetrical*. Like the choice of a vacation destination, this has a perverse influence on the philosopher's analysis and could very well lead to suboptimal choices.

More specifically, political philosophers are in the business of offering normative justifications for political and economic institutions – that we should have a democracy, an epistocracy, a centrally planned economy, a market system, and so on. Doing so requires the philosopher to make comparisons between these systems: a democratic system might have desirable property *x*, whereas an epistocracy might have undesirable property *y*. But for these comparisons to be meaningful and our choice justified, our analysis requires that we employ symmetrical assumptions in both cases. In other words, the assumptions we use when thinking about what a democracy might look like must be the same ones we use when we think about what an epistocracy might look like. Many philosophers do not do this, however. They might assume that everyone in a democracy is informed and votes benevolently in the public interest and that the bureaucrats running the epistocracy are malevolent and only pursue their self-interest. Clearly, such asymmetric assumptions are unjustified and can result in an undesirable institutional choice.

Recent work by political philosophers has done much to correct these sorts of problems (Section 2). But though some cases of asymmetric idealization have been corrected, others remain. In particular, political philosophers tend to have rich accounts of democracy that not only appeal to the sorts of *outcomes* that democracies yield, but also the kinds of *processes* implicit in democratic systems (Section 3). On the other hand, much discussion of markets only focuses on market outcomes; there is not much discussion of the *market process* (Section 4). This results in a rich picture of democracy but an impoverished understanding of markets. More generally, this particular kind of asymmetric idealization wrongly biases the political philosopher against markets and toward democracy. The chapter ends by offering a case study in asymmetric idealization of market and democratic processes (Section 5). In particular, I show that one of the most prominent recent justifications of democracy is more friendly to market institutions than its proponents realize, *if* asymmetric idealizations are corrected and a more equitable comparison undertaken.

2. POLITICAL PHILOSOPHY AND ASYMMETRIC IDEALIZATION

Though they were not political philosophers,[1] James M. Buchanan and Gordon Tullock corrected an important and pervasive instance of asymmetric idealization among economists in their masterpiece *The Calculus of Consent*. The book is rife with insights, but the most important move the authors make is application of the *homo economicus* behavioral model – almost universally employed by economists in their analyses of markets – to political actors in the analysis of political institutions. *Homo economicus* says that persons are self-interested in the sense that they maximize their utility, or pursue the satisfaction of their preferences. This is often (but not always) more narrowly interpreted as saying that persons pursue the maximization of their personal wealth.[2] Such an assumption is standard in the economist's analysis of market behavior. Buchanan and Tullock insisted that we use this same assumption in our analysis of political behavior as well.

The main justification for this move appeals to the importance of symmetrical assumptions for meaningful analysis and optimal choice over institutions. Though Buchanan and Tullock offer such an argument,[3] the case is most artfully stated in a piece by Buchanan coauthored with Geoffrey Brennan:

> On the basis of elementary methodological principles it would seem that the *same* model of behavior should be applied across different institutions or different sets of rules. The initial burden of proof must surely rest with anyone who proposes to introduce differing behavioral assumptions in different institutional settings …. If an individual in a market setting is to be presumed to exercise any power he possesses (within the limits of market rules) so as to maximize his net wealth, then an individual in a corresponding political setting must also be presumed to exercise any power he possesses (within the limits of political rules) in precisely the same way.[4]

Importantly, public choice theorists do not suggest that the political economist must always use the same behavioral model in analyzing political institutions and market institutions. Rather, their claim is only that this ought to be the presumption, which can be overturned if we have empirical reasons for thinking that persons *do* in fact act differently in markets when compared to the political arena: "The ultimate defense of the economic-individualist behavioral assumption must be empirical."[5] But still, the presumption of symmetrical behavior leads to important results in the analysis of political and economic institutions.

Before the public choice revolution, much work in economics simply identified *market failures* and then proposed remedies for these failures to be carried out by benevolent government officials working in the public interest.[6] But once we assume that the same self-interested persons who inhabit our economic institutions *also* inhabit our political institutions, things change. In particular, it is now possible to encounter *government failures* just as serious as market failures.[7] This is not to say that there is never any reason for political actors to interfere with markets, only that what we should do when we encounter market failure is far less clear. In some cases, the government remedy will be worse than the market disease. As a result, it is best to leave the market untouched in such cases.

Buchanan and Tullock's main insight points out the unjustified use of asymmetric assumptions by political economists and implores them to correct this. Recent work highlights a similar problem in the realm of political philosophy. Consider, for instance, G. A. Cohen's famous defense of socialism in *Why Not Socialism?* In painting an idyllic picture of a socialist camping trip, Cohen assumes that persons "care about, and, where necessary and possible, care for, one another, and, too, care that they care about one another."[8] Yet when thinking about what a capitalist camping trip would look like, he assumes that persons are primarily moved by "greed and fear," such that "a person does not typically care *fundamentally*, within market interaction, about how well or badly anyone other AQ1 than herself fares."[9] Of course, socialism is preferred to capitalism under such assumptions. This is an example of asymmetric idealization very similar to the kind Buchanan and Tullock corrected. Very roughly, persons are morally good when they are on the socialist camping trip but morally bad when they are on the capitalist camping trip.

Jason Brennan highlights this flaw in Cohen's reasoning in his book-length response, *Why Not Capitalism?* In offering a parody of Cohen's reasoning, he imagines an ideal capitalist society inhabited by strictly benevolent beings and then compares this to a dystopian socialist society populated by malevolent persons who pursue only their self-interest. Under such assumptions, capitalism is now preferred to socialism. Brennan's point is not that this should be the final word. The purpose of the parody is to show how problematic our analysis will be if we employ asymmetric assumptions. If we assume people are good in a socialist system and bad in a capitalist system, then socialism almost trivially wins; if we assume people are good in a capitalist system and bad in a socialist system, then capitalism almost trivially wins. This suggests that when examining capitalism and socialism, we ought to assume either that persons in both societies are good or that persons in both societies are bad. When we do this, Brennan thinks that capitalism is more attractive as a normative ideal. His main point, though, is the importance of symmetrical assumptions for meaningful analysis and optimal institutional choice.

Another example of asymmetric idealization in political philosophy occurs in John Rawls's *A Theory of Justice*. In this work, Rawls assumes that a person will "strictly comply" with whatever conception of justice governs society, in that he is "presumed to act justly and to do his part in upholding just institutions."[10] As an example of this, in his discussion of political behavior among representatives in a legislature, Rawls says that such government officials

> represent their constituents in the substantive sense: they must seek first to pass just and effective legislation, since this is a citizen's first interest in government, and secondly, they must further their constituents' other interests insofar as these are consistent with justice.[11]

Yet even so, market actors in Rawls's analysis are not quite as public spirited as political actors are. They do not, for instance, voluntarily contribute to public goods.[12] Nor will they work harder for the benefit of the least advantaged without a financial incentive to do so[13] – this fact is what grounds Rawls's endorsement of the difference principle, rather than a principle of perfect equality. As Christopher Freiman phrases it, "Rawls's ideal theory assumes partial compliance with justice to generate a need for the state and then assumes *full* compliance to stipulate the ideality of the state."[14] According to Freiman, a shift to symmetrical nonideal assumptions about agent motivation should "prompt Rawls and other liberal egalitarians to rethink their rejection of a free market, classical liberal state."[15]

The cases of asymmetric idealization that Brennan and Freiman point out are deeply important. Once these problematic assumptions are corrected, the results of Cohen's and Rawls's analyses likely change. But Brennan and Freiman do not go far enough. There are *other* cases of asymmetric idealization that are just as problematic as the motivational ones they point out that also lead to poor analysis and suboptimal institutional choices. In particular, I refer to an asymmetric understanding of how markets and democratic institutions operate that wrongly biases the political philosopher toward democracy and against markets. This shall be our focus for the remainder of the chapter.

3. DEMOCRATIC OUTCOMES AND DEMOCRATIC PROCESSES

Many political philosophers defend a robust account of democracy. They believe that many of our most important social and political decisions ought to be decided democratically, rather than through some other kind of institutional arrangement. This might strike some as surprising, because much work in the social sciences reveals that democracies can often yield undesirable outcomes.

Consider just one example. Kenneth Arrow's important work in *Social Choice and Individual Values* points out the potential incoherence that democratic institutions might yield. The details of Arrow's impossibility theorem are not important for our purposes.[16] Roughly, the theorem states that *any* method of aggregating votes that satisfies certain desirable properties could potentially result in incoherent decisions.[17] In particular, a democracy could end up deciding that choice *a* is better than choice *b*, which is better than choice *c*, which is better than … choice *a* again. Such a series of choices strikes many of us as deeply irrational. In the words of William Riker, Arrow's "conclusion appears to be devastating, for it consigns democratic outcomes – and hence the democratic method – to the world of arbitrary nonsense, at least some of the time."[18]

Democrats respond to these worries by suggesting that we have a far too attenuated understanding of democracy. In particular, we are focusing too much on possible outcomes of a vote, not on other important processes that are implicit in a democracy. The outcomes of democracy – what Arrow, Riker, and other social choice theorists focus on – result from a vote, but much of the democratic process consists of robust deliberation that occurs before the vote is ever taken. Persons give arguments for the positions they hold; rebuttals are offered, and these rebuttals are in turn responded to. Over time, some arguments are sharpened, others are dropped completely, and people's positions on key issues change. Importantly, this process of deliberation alters the kinds of outcomes we would expect to occur from a vote. If we simply voted without deliberation, then perhaps things would not go so well; but adding the process of deliberation can perhaps result in significantly better outcomes.

Relevant to the current discussion, many democratic theorists hold that the process of democratic deliberation can assuage many of the fears invoked by Arrow and his fellow social choice theorists.[19] Quite explicitly: "Deliberative democratic theory is relevant to social choice theory in that deliberation can complement aggregation and open up an escape route from some of its negative results."[20]

The general idea is this. Arrow's impossibility theorem shows that under *some* kinds of preference configurations, voting will result in incoherent choices. This means, though, that under some kinds of preference configurations a democratic vote will *not* result in incoherent choices. One way for this to happen is if preferences are what is called *single-peaked*.

The details of single-peaked preferences are not important.[21] What is important is that deliberative democrats argue that if deliberation precedes a vote, then this deliberation will likely result in preferences that are single-peaked.[22] The specifics of this argument are a bit complicated, but the general idea is that deliberation – though it does not induce unanimity – does induce a "meta-consensus," which means that persons at least now judge issues across the same evaluative dimensions. Single-peaked preferences, though, just are preferences that evaluate an issue across a single evaluative dimension. Thus, by inducing a meta-consensus, deliberation also induces single-peaked preferences. When these single-peaked preferences are inserted into the voting booth, they will *not* result in an incoherent choice. Arrow's damning results are thus evaded.

Here we have one example of how focusing on the process of deliberation can do much to change our conclusions concerning the desirability of democracy. There are other examples as well. Many hold that democracies make bad decisions because of the deeply uninformed nature of the participants who vote: garbage in, garbage out.[23] Some respond, however, by arguing that through properly structured deliberation, democracies can account for these sorts of problems and make better decisions.[24] Again, the key move here is that once we focus on the process of deliberation rather than merely analyzing democracy in terms of voting outcomes, our overall evaluation of democracy changes.

There is nothing wrong with the democratic theorist focusing on the process of deliberation. Such contributions are important and fruitful. However, it *would* be problematic if, in undertaking comparative institutional analyses, political philosophers failed to examine the rich processes that might be present in other institutional arrangements. If, for instance, they only looked at possible market outcomes and not the market process as well, then we would have another case of asymmetric idealization on our hands. Such a case of asymmetric idealization seems prima facie unjustified and could lead to suboptimal institutional choices. Perhaps when we compare democracy (understood in terms of voting along with the process of deliberation) to markets (without taking into account the market process), we think that democracy is superior to markets. Yet when we account for the market process, perhaps markets now beat democracy. To avoid these sorts of errors, it is important to understand and account for the rich market process that accompanies market institutions. This is what I turn my attention to in the next section.

4. MARKET OUTCOMES AND THE MARKET PROCESS

Political philosophers tend to have a limited understanding of markets. Many appeal to general equilibrium models and their two corresponding welfare theorems. Very roughly, general equilibrium accounts of markets are models in which there are multiple firms producing different kinds of goods and multiple consumers who can purchase and then consume these goods. The first welfare theorem says that – under heavily idealized and deeply unrealistic conditions, including perfect information, an infinite number of producers and consumers, and zero transaction costs, to name a few – markets always produce an efficient outcome. This means that there is no way of redistributing resources that does not make at least one person worse off. The second welfare theorem says that markets – again, under heavily idealized and deeply unrealistic conditions – can reach *any* efficient distribution of resources. Though these results seem quite optimistic at first, the flipside is that when these heavily idealized and deeply unrealistic conditions are not met, the theorems no longer hold. This is particularly important for the first theorem. This theorem says that under restricted conditions the market is always efficient; yet when these restricted conditions are relaxed, the market will fail to be efficient, in that there are mutually beneficial gains from trade that could make some people better off (at no one's expense) that were passed by. In other words, when the restrictive assumptions of general equilibrium models are not satisfied, markets fail. In the likely event of this happening, many believe that government must step in and remedy the failure.

As already mentioned, when political philosophers discuss markets, they often understand them in terms of general equilibrium models and their corresponding results. In particular, they are quick to point out the presence of market failures as soon as we depart from ideal conditions, which then suggests the necessity of government intervention. Consider what Rawls has to say:

> The theory of general equilibrium explains how, given the appropriate conditions, the information supplied by prices leads economic agents to act in ways that sum up to achieve [an efficient] outcome. Perfect competition is a perfect procedure with respect to efficiency. Of course, the requisite conditions are highly special ones and they are seldom if ever fully satisfied in the real world. Moreover, market failures and imperfections are often serious, and compensating adjustments must be made [to correct them].[25]

Rawls is not alone here. Political theorists Jack Knight and James Johnson articulate a similar view of markets:

> The difficulty is that absent such conditions, not only will market competition potentially generate an inequitable distribution along the efficiency frontier … but it generally cannot be relied upon to generate efficient outcomes at all.[26]

Amartya Sen's moral analysis of the market also crucially relies on the two fundamental welfare theorems.[27] Finally, Joseph Heath has constructed an entire theory of business ethics grounded in the notion of market failure.[28]

Understanding markets solely in terms of general equilibrium models and their corresponding formal results is akin to understanding democracy solely in terms of Arrow's impossibility theorem. If we only focus on the outcomes of votes, then democracy can lead to irrational and bizarre outcomes. And if we only focus on the equilibrium outcomes of markets, then market failures will often occur and gains from trade that could be realized will be passed over. The democrat responds by saying that focusing on the process of deliberation should ease our worries about potentially irrational democratic decisions. I believe there is a similar process that defenders of markets can appeal to that would likewise ease our worries about market failures. If I am right about this, then the imperative to symmetrically idealize would require political philosophers to consider such processes in their comparative institutional analyses, contra the passages examined in the paragraph above.

Relevant here is the work of Israel Kirzner on entrepreneurship and the market process. In developing his theory of the market process, Kirzner's prime targets are those equilibrium models of markets that are used to produce results such as the first and second welfare theorems. Now there are many features of these models that I lack the space to carefully explicate. Importantly, one feature of these models is that they are populated by two sorts of agents: there are consumers, who attempt to maximize their utility by acquiring their most preferred consumer bundle for the least amount subject to their budget constraint, and producers, who attempt to maximize their profits. As Arrow and Gérard Debreu describe it in their seminal paper on general equilibrium theory:

> It was assumed that each consumer acts so as to maximize his utility, each producer acts so as to maximize his profit, and perfect competition prevails, in the sense that each producer and consumer regards the prices paid and received as independent of his own choices.[29]

Kirzner's main criticism of these sorts of models is that they cannot explain how it is that markets ever self-correct when they fail. Consider an example he offers:

> Let us imagine a market in which all those currently participating are in fact *unable* to learn from their market experience. Would-be buyers who have been returning home empty-handed (because they have not been offering sufficiently high prices) have *not* learned that it is necessary to outbid other buyers; would-be sellers who return home with unsold goods or resources (because they have been asking prices that are too high) have *not* learned that they must, if they wish to sell, be satisfied with lower prices. Buyers who have paid high prices do not discover that they could have obtained the same goods at lower prices; sellers who have sold for low prices do not discover that they could have obtained higher prices.[30]

Clearly, we do not see this in the real world. Markets almost always fail in the sense that some mutually beneficial gains from trade are left uncaptured. But errors are identified, markets adjust, and gains from trade once passed over are captured in the future. Yet can a model of market interaction characterized solely by Arrow-Debreu maximizers explain this process of correction and learning? Continues Kirzner: "A market consisting exclusively of economizing, maximizing individuals does not generate the market process we seek to understand."[31] That is, standard equilibrium models of markets are inadequate because they do not give us insight concerning the market process. These models cannot explain how markets begin correcting when they fail to be in equilibrium.

In response to the failures of these models, Kirzner introduces a slightly more sophisticated model of markets that is still quite simplified and heavily idealized.[32] According to the new model, we can think of there being three types of actors in the market, instead of two:

consumers, who maximize their utility by acquiring their most preferred consumer bundle for the least amount subject to their budget constraint;

producers, who maximize profits; and

entrepreneurs, who are alert to new ends that can be maximized and alert to new means that can be used to maximize new or existing ends.

Introduced here is the entrepreneur. The entrepreneur, according to Kirzner, does not merely maximize relative to constraints as producers and consumers do, but rather actively seeks new ends to maximize and new means by which to maximize new or existing ends. Note that the role of the entrepreneur in the market process is not subject to analysis by the common rational choice paradigm. Part of Kirzner's broader, more philosophical point is that standard economic theory adopts an impoverished understanding of human action precisely because it analyzes human action solely within the means-ends framework. Yet real human actors are

> endowed not only with the propensity to pursue goals efficiently, once ends and means are clearly identified, *but also with the drive and alertness needed to identify which ends to strive for and which means are available* (emphasis mine).[33]

Again, Kirzner's model of the market is heavily stylized. In reality, persons are neither producers, nor consumers, nor entrepreneurs. Rather, we are all some combination of the three. In particular, we all embody the entrepreneurial element in human action whenever we change our constraints through discovery. But still, the simple model *is* able to answer the puzzle that standard equilibrium models fail to address: namely, how do markets begin self-correcting when they fail? Writes Kirzner:

> Into this imaginary world of men unable to learn from their market experience let us now introduce a group of outsiders who are themselves neither would-be sellers nor would-be buyers, but who *are* able to perceive opportunities for entrepreneurial profits; that is, they are able to see where a good can be sold at a price higher than that for which it can be bought. This group of entrepreneurs would, in our imaginary world, immediately notice profit opportunities *that exist because of the initial ignorance of the market participants* and that have persisted because of their inability to learn from experience.[34]

These entrepreneurs begin correcting market failures by buying at low prices from those sellers who have not discovered that some buyers are paying too high prices, while also selling goods at high prices to those buyers who have not discovered that some sellers have been selling too low. This allows for gains from trade once passed by to now be captured. In doing so, the market begins correcting its own initial failure.

Entrepreneurs alert to market failures who then introduce new means and new ends generate the market process that Kirzner spent his illustrious career examining. Clearly, we lose sight of this process if we focus only on formal equilibrium models, populated solely by producers who make things and consumers who buy things. Not only this, but focus on the market process should change how we interpret the formal results that follow from these models. Recall: The first theorem of welfare economics says that, under certain conditions, markets are always efficient. Yet when these conditions are not met, markets fail.

Given the highly restricted nature of the assumptions used in proving the theorem, such results often inspire pessimism about markets (in that they almost always fail) and emphasize the need for government intervention. Yet this initial reaction does not consider the market process or the way in which markets correct failures through entrepreneurial alertness. Once we consider this richer picture of markets, our pessimism should not be so great, and the turn to government intervention not so quick. This is not to say that there is never any role for government intervention in markets, only that within markets is a mechanism capable of correcting the markets' own failure. This solution must then be compared to the prospect of government remedying the failure.

Indeed, reconsidering our evaluations of markets in light of market process theory is akin to reconsidering our evaluations of democracy in light of the deliberative process. Arrow's initial results inspire pessimism about the rationality of democratic decisions, but focusing on deliberation shows us that things aren't as bad as they first appear. Similarly, equilibrium models inspire pessimism about the ubiquity of market failures, but focusing on the entrepreneurial market process should alleviate these worries. Given that political philosophers already emphasize the deliberative process implicit in democracies yet neglect the market process implicit in markets, an emphasis on employing symmetrical assumptions in regard to institutional processes might very well change the results of the political philosopher's theorizing. The next section examines a case study highlighting this. A recent justification of democracy – once it adheres to symmetry and considers the deliberative democratic process *and* the market process – may actually lead to a justification of markets instead.

5. THE PRIORITY OF THE MARKET?

In their recent book *The Priority of Democracy*, political theorists Jack Knight and James Johnson argue (i) that if we are to be pragmatists, then (ii) democratic institutions must receive priority over other possible institutional arrangements. This section grants (i) but calls into question (ii). In particular, I contend that when arguing for the priority of democracy, Knight and Johnson asymmetrically idealize. If this asymmetric idealization is corrected, then Knight and Johnson's pragmatism framework may actually lead to the priority of markets over democracy. I do not argue that their framework does, in fact, lead to the priority of markets over democracy; I do not have the space to adequately do this. I merely wish to highlight that the case for democracy's priority over the market is not so clear-cut once we correct for asymmetric idealization.[35]

Knight and Johnson focus on the question of institutional choice. The question of which institutions we should implement to adjudicate conflicting claims in society can be broken down into two separate questions. The *first-order* question asks: for any domain of social life s_n, which institutional arrangement ought to govern s_n? As an example: Which institutions ought to govern the relationships between members of a family? Between trading partners? Between different nations in the international arena? The *second-order* question asks: For all domains of social life s_1, s_2, … s_n, which institutions should we use to choose which institutions should govern any particular s_n? That is, which institutions should we use to decide should govern the family? Which institutions should we use to decide should govern the relations between trading partners or between different nations in the international arena? In arguing for the priority of democracy, Knight and Johnson claim that it receives second-order priority: it is the institutional arrangement we ought to adopt to select which institutions should then govern particular domains of social life. For *any* particular s_n, we use democracy to decide which institutions should govern s_n. AQ2

One key feature of Knight and Johnson's pragmatist theoretical apparatus is a necessary condition they introduce that an institutional arrangement must satisfy before it is a permissible candidate for second-order priority. This condition is *reflexivity*. If an institutional arrangement is *not* reflexive, then it is not a permissible candidate to receive second-order priority; if an institutional arrangement *is* reflexive, then it is a permissible candidate to receive second-order priority. According to the authors, an institutional arrangement is reflexive if it is able to "monitor and assess its own ongoing performance."[36] That is, institutions that receive second-order priority must not only be capable of assessing and evaluating which institutions should govern different domains of social life, but they must also be capable of assessing and evaluating *themselves*. Reflexive institutions not only ask whether certain institutions *will* perform well in a given s_n, and whether certain institutions *are* performing well in a given s_n, but whether the institutional arrangement *itself* is functioning properly – if it is not, then reflexive institutions can take steps to remedy such failure. If an institutional arrangement is not reflexive, then it can get trapped in a poorly functioning equilibrium.

As stated in the introduction to this section, the authors think democracy – not markets – should receive priority as our second-order institutional arrangement of choice. Knight and Johnson establish this conclusion by arguing, first, that democratic institutions are reflexive[37] and, second, that markets (and other possible institutional arrangements) are not reflexive.[38] Markets thus lack the key necessary condition required for them to even be a permissible candidate for receiving second-order priority in the first place. I do not dispute the authors' claim that democratic institutions are reflexive. Rather, I am concerned with whether markets can be reflexive, and in particular how market reflexivity relates to market failure and the market process.

Why do markets fail to be reflexive? There seem to be two distinct worries, illustrated in the following two passages:

> The key here is that market interaction … [is] decentralized in the sense that those party to any particular interaction are charged neither with reviewing nor with monitoring in an ongoing way the conditions under which institutions of exchange … themselves operate nor with assessing the consequences of how broader institutional arrangements operate.[39]

> The crux of our argument is that markets do not facilitate the types of communication necessary for the tasks of institutional assessment and monitoring. In perfect markets, prices convey all of the information necessary for effective choice. Communication between actors is about particular exchanges and not about the general functioning of the market itself. As communication extends to other types of issues, markets tend toward imperfection and inefficiency.[40]

The first passage asserts that there are no actors in the market specifically tasked with assessing and monitoring the performance of the market: market actors are simply trading partners, and are not "charged" to do anything else. If this is true, then there is no mechanism by which markets are capable of assessing and monitoring themselves: there exists no one to carry out this distinctly reflexive task. The second passage asserts that the kind of communication required for reflexivity is also not present in the market given the nature of market interaction. After all, *even if* there were some agents who assessed and monitored the functioning of the market itself, they would also need to communicate these findings to the rest of society for society to use this information in order that it may make a rational social choice. Markets fail to be reflexive, then, across two metrics: first, they lack agents to assess and monitor the functioning of the market, and second, even if they did have such agents, these agents would lack the proper channels of communication to reveal their findings.

Key here is how Knight and Johnson understand markets when they levy the charges examined above. As can likely be surmised by the reader, Knight and Johnson understand markets in terms of general equilibrium models, neglecting the market process explicated at length in the prior section. Indeed, Knight and Johnson quote the exact passage from Arrow and Debreu cited in the previous section concerning market actors, where all market actors are characterized as either firms maximizing profits or consumers maximizing consumption.[41] If this is *all* individuals do when they enter the marketplace – engage in pure consumption or pure production – then Knight and Johnson are right to say that there is no assessment, monitoring, or communication concerning the underlying performance of the market. Market actors merely buy and sell things, and the market fails to be reflexive.

Knight and Johnson's picture of the market, however, neglects Kirznerian entrepreneurs and their role in the market process. And once we adopt this richer understanding of markets, a case can be made that markets *do* possess the important reflexive property. Begin with assessment and monitoring, one of the key components of reflexivity. Clearly, entrepreneurs as defined by Kirzner satisfy this crucial function. By definition, entrepreneurs have the property of *alertness*, which is their propensity to be sensitive to new means or new ends they can introduce into the marketplace to remedy current market failures. This constant alertness that characterizes the entrepreneur essentially fills the role of assessment and monitoring that Knight and Johnson require of reflexive institutions. The entrepreneur constantly assesses and monitors how the market functions, actively seeking out market failures and actively thinking of new means and new
AQ3 ends he/she can introduce to remedy these failures and capture new gains from trade going forward. It is true that entrepreneurs are not "charged" with this task by any kind of central authority, to use the authors' terminology. In the marketplace, this role of assessment and monitoring is instead incentivized via entrepreneurial profits: "The ceaseless quest for profits by those eager entrepreneurs drive the market system toward realizing gains from trade and gains from innovation."[42] Still, what motivates entrepreneurs to monitor and assess the functioning of the market is of secondary importance. What is crucial is that this type

of market actor is *constantly* monitoring and assessing the market's performance and, moreover, seeking to remedy failures in the market's performance when he/she discovers them.

But it is not enough for reflexive institutions to have persons monitoring and assessing the institution's performance – Knight and Johnson also require some kind of communication concerning the findings of this assessment and monitoring to society at large. And this is why, it might be thought, markets fail to be reflexive. For though entrepreneurs indeed monitor and assess the market's performance, it is not clear in what sense they communicate their findings to others. Here it matters what is meant by "communication." If by communication we mean literal face-to-face discourse, then it is clear that entrepreneurs do not do this. But communication need not be understood in such a literal sense – so long as entrepreneurs can send some kind of signal about the market's performance, which should be sufficient. And here we again see the key role entrepreneurial profits play. Not only do entrepreneurial profits incentivize entrepreneurs to assess and monitor the market's performance, they also communicate via the price system where markets have failed and where they are currently being corrected – the making of entrepreneurial profits is evidence that gains from trade had once been passed by and are now currently being captured. Just as the price system normally understood communicates information concerning the supply of and demand for scarce resources, entrepreneurial profits communicate the findings of the entrepreneur's assessment and monitoring of the market's overall functioning.[43] Communicating in this way is sufficient for markets to be reflexive.

Focusing on the market process thus reveals that markets satisfy the necessary reflexivity property that is crucial to Knight and Johnson's pragmatist justificatory framework. This is especially important, given that Knight and Johnson adopt an understanding of democracy that depends on democracy's deliberative process. Indeed, the authors spend a good deal of space examining Arrow's impossibility theorem and what this means for the rationality of democracy. Along the lines discussed in Section 3, Knight and Johnson argue that properly structured deliberation can make it such that these results are no longer relevant.[44] Thus, democratic processes play a key role in their analysis. By symmetry, so should the market process. And once the market process is included in the analysis, it is clear that markets possess the necessary reflexivity property.

We have seen so far that markets are capable of being reflexive and are thus capable of performing Knight and Johnson's second-order task of institutional choice. This, of course, does not show that the market should receive second-order priority over other possible institutional arrangements, such as Knight and Johnson's favored democracy. To show that markets ought to receive second-order priority over democracy, one must do either one of two things. First, one can show that democratic voting and deliberative procedures fail to be reflexive. Or one can show that *even though* democracy is reflexive, the market is likely to perform better as a second-order institutional arbiter than democracy. Knight and Johnson convincingly argue that democracy (through the deliberative process) is, in fact, reflexive. So, if one wanted to go further and argue for the priority of the market, one would have to show that markets are better at performing their reflexive task when compared to democracy. I lack the space to make this kind of argument, so I only embrace the weaker claim: once asymmetric idealization is corrected, Knight and Johnson's pragmatism framework may very well lead to the priority of the market over democracy. Whether it does depends on a careful analysis concerning which institutional arrangement is more likely to perform the crucial reflexive task.

6. CONCLUSION

This chapter began with a clear problem that often occurs in the political philosopher's analysis: the use of asymmetric idealizations or assumptions. Not only do such assumptions strike many as unjustified, but they can often lead to suboptimal institutional choices. Recent work has done much to correct these problems when it comes to behavioral assumptions. Political philosophers wrongly assume that actors will behave in a morally admirable manner when inhabiting some institutions and a morally deplorable manner when inhabiting others. Remedying these flaws is important, but it does not go far enough. For political philosophers employ another kind of unjustified asymmetric idealization. They sometimes focus on processes along with outcomes when it comes to some institutional frameworks but completely ignore processes in others. In particular, once the political philosopher pays as much attention to the market process as he/she does to the deliberative democratic process, he/she will find that there is much more to be said in defense of markets than initially seems to be the case. This corrects the unjustified bias political philosophers have toward democracy and against markets.

NOTES

1. Although Buchanan did make significant contributions to social contract theory. For an overview, see Kogelmann, "Rawls, Buchanan, and the Search for a Better Social Contract."
2. For an overview of these different conceptions of *homo economicus* as deployed in public choice theory, see Kogelmann, "Modeling the Individual for Constitutional Choice."
3. Buchanan and Tullock, *Calculus of Consent*, 17–9.
4. Brennan and Buchanan, *Reason of Rules*, 56.
5. Buchanan and Tullock, *Calculus of Consent*, 27.
6. For example, Samuelson, *Economics*, 151.
7. For example, Buchanan, "Politics, Policy, and the Pigovian Margins."
8. Cohen, *Why Not Socialism?*, 34–5.
9. Cohen, *Why Not Socialism?*, 44–5.
10. Rawls, *Theory of Justice*, 8.
11. Rawls, *Theory of Justice*, 221.
12. For example, Rawls, *Theory of Justice*, 267.
13. This assumption of Rawls's plays a crucial role in Cohen's criticism of the difference principle in *Rescuing Justice and Equality*.
14. Freiman, *Unequivocal Justice*, 26.
15. Freiman, *Unequivocal Justice*, 2. For criticism of Freiman's interpretation of Rawls, see Kogelmann, "Christopher Freiman."

16. I cover the details in Kogelmann, "Buchanan and Arrow on Democracy, Impossibility, and Market."

17. Arrow actually argued that his impossibility theorem applies to both voting and markets, although almost everyone in the secondary literature interprets the impossibility theorem as applying only to political institutions. For an overview of this issue, see Kogelmann, "Buchanan and Arrow on Democracy, Impossibility, and Market."

18. Riker, *Liberalism against Populism*, 119.

19. This is not the only response democrats have offered when confronted with Arrow's impossibility theorem. For an overview, see Mackie, "Reception of Social Choice Theory by Democratic Theory."

20. List, "Democratic Deliberation and Social Choice," 2. For a comprehensive overview of deliberative-democratic responses to social choice theoretic results, see List, "Democratic Deliberation and Social Choice."

21. For an overview of single-peaked preferences, see List, "Democratic Deliberation and Social Choice," 11.

22. For example, Miller, "Deliberative Democracy and Social Choice"; Knight and Johnson, "Aggregation and Deliberation"; and Dryzek and List, "Social Choice Theory and Deliberative Democracy."

23. For example, Caplan, *Myth of the Rational Voter* and Somin, *Democracy and Political Ignorance*.

24. For example, Landemore, *Democratic Reason*.

25. Rawls, *Theory of Justice*, 272.

26. Knight and Johnson, *Priority of Democracy*, 60.

27. Sen, "Moral Standing of the Market," 9–14.

28. Heath, *Morality, Competition, and the Firm*.

29. Arrow and Debreu, "Existence of an Equilibrium for a Competitive Economy," 265.

30. Kirzner, *Competition and Entrepreneurship*, 11.

31. Kirzner, *Competition and Entrepreneurship*, 25.

32. Kirzner, *Market Theory and the Price System*, 16–8.

33. Kirzner, *Competition and Entrepreneurship*, 27.

34. Kirzner, *Competition and Entrepreneurship*, 11.

35. Pennington (in "Robust Political Economy and the Priority of Markets") argues for a similar conclusion, though the argument he presents is orthogonal to the one presented here, in that it is grounded not in market process theory, but rather the robust political economy framework.

36. Knight and Johnson, *Priority of Democracy*, 169 and Knight and Johnson, "Priority of Democracy," 55.

37. Knight and Johnson, *Priority of Democracy*, ch. 5.

38. Knight and Johnson, *Priority of Democracy*, ch. 6.

39. Knight and Johnson, "Priority of Democracy," 56.

40. Knight and Johnson, *Priority of Democracy*, 170.

41. Knight and Johnson, *Priority of Democracy*, 168.

42. Boettke, "Entrepreneurship, and the Entrepreneurial Market Process," 234.

43. Kirzner, "Economic Calculation Debate," 4 and Kirzner, "Entrepreneurial Discovery and the Competitive Market Process," 62.

44. Knight and Johnson, *Priority of Democracy*, ch. 4 and Knight and Johnson, "Aggregation and Deliberation."

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AQ1: Please note that "Ibid" in footnotes has been replaced with the corresponding cross-references. Kindly check the footnotes 9, 11, 15, 15, 20, 21, 31, 34, 38, and 41 for correctness.

AQ2: Please check whether the edit made to the sentence "That is, which institutions should……" (and the next sentence also) conveys the intended meaning.

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