LIVING WITH THE INVISIBLE HAND

Markets, Corporations, and Human Freedom

WAHEED HUSSAIN

EDITED BY

ARTHUR RIPSTEIN AND NICHOLAS VROUSALIS

Living with the Invisible Hand

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Foreword

For those of us who knew him, reading Waheed Hussain's book brings a mixture of sadness and pleasure: sadness at the loss of having his life cut short, and pleasure in hearing again his unique voice and being guided by his distinctive mind.

The main aim of the book, and what I hope will be its important impact, is to open up in a new way the discussion of the relation between freedom and equality. In much discussion, particularly but not exclusively on the right, freedom is understood in terms of the widest range of individual choice, which, it is assumed, the pursuit of equality is bound to restrict. Waheed takes seriously individuals' reasons for wanting to have a choice about how their lives go. He points out, however, that these values do not determine the form that an economic system should take, since many different economic systems can respect these values. These systems differ in the options they make available to individuals and in the incentives that individuals have for choosing among them. They are thus systems of social control that "steer" individuals to lead their lives in certain ways. They are also dynamic systems that change these options and incentives over time, and differ in the ways that they do this. In a "free market" economy of the kind favored by classical liberals, for example, the options and incentives are determined by supply and demand. They therefore change with changes in technology and in aggregate demand for products and services, disrupting individuals' lives by loss of employment. (The suggestion is not that this kind of change can be avoided, but only that the cost it imposes on individuals needs to be taken into account in justifying the system of control.)

The problem that Waheed identifies with such dynamic systems of coordination and social control is that they direct individuals' choices in ways that are independent of the individuals' own rational faculties. The book is addressed to the question of how such "judgment-bypassing" systems of control can be justified; Waheed's answer, developed at length, is that they must satisfy the three conditions of reason-sensitivity, transparency, and trustworthiness.

These conditions can be illustrated by the simple example of judgment-bypassing measures that Sunstein and Thaler (2008) call "nudges," such as encouraging employees to save more for retirement by making payroll deductions for retirement saving the default state that employees must opt out of rather than an alternative they must affirmatively choose. Waheed's three conditions explain why many find the idea of such nudges objectionably manipulative. Reason-sensitivity requires that having their choices presented in this way is actually in the employee's own interests. Even if this is so, being nudged may strike employees as manipulation insofar as what is going on is hidden from them. The condition of transparency addresses this by requiring that, insofar as feasible, employees should be put in a position to understand the rationale for these nudges. But, in addition, permitting human resource departments to "nudge" employees may seem objectionable to them because they suspect that HR department will not always be moved to do things that are in fact in the interest of employees rather than serving the conflicting interests of managers and shareholders. This problem of trustworthiness could, for example, be addressed by requiring the way in which options are presented to employees to be approved through a process in which employees are represented.

Applying this analysis to the larger-scale problem of a market economy, Waheed argues in the final chapters of the book (which are somewhat less finished than the rest) that a system in which corporations have the authority to make judgment-bypassing decisions that shape the options of workers and consumers is justified only if these decisions are reached through a process such as the German model of codetermination, in which these groups are represented.

Waheed defends his distinctive view with philosophical depth and subtlety and with much greater familiarity with economics and with the nature of corporations than is common among political philosophers. (This is, perhaps, an effect of his having been "steered" by the job market into his first job at the Wharton School rather than in a traditional philosophy department.)

Waheed's book offers a novel philosophical perspective on fundamental questions facing us as a society. His argument is clear, instructive, engaging, and even exciting to read. If it receives the wide attention it deserves, his ideas will have important lasting effects even though, regrettably, he is no longer here to defend and develop them.

T. M. Scanlon

Editorial Preface

Waheed Hussain passed away in January 2021. The book at hand, which was his main philosophical vocation, provides a philosophical account of the possibility of reconciliation between human freedom and market institutions.

The market plays a central role in the lives of most people in the world today. More importantly, according to Hussain, the market represents one central mechanism of governance, which plays a pivotal role in shaping how we live our lives. When the market arrangement works as it should and when members of a community adhere to its requirements, they take part in an enterprise that draws them into a certain pattern of conduct—i.e., an efficient pattern of production and consumption. However, the arrangement draws individuals into the pattern without regard for their private judgments about that pattern. An arrangement that bypasses individual judgments to maintain a certain pattern might not, Hussain thinks, be consistent with an appropriate respect for human freedom.

In this book, Hussain argues that markets, much like states, are systems of governance. Their justification must therefore meet similar standards of moral scrutiny, despite the fact that their authoritarian structure is impersonal. The book's central contribution to the literature consists in fleshing out and defending an account of market governance that is consistent with respect for persons as free and equal.

In order to achieve this reconciliation, Hussain provides a philosophical account of market institutions. Shared social institutions, he argues, define a framework for how members of a political community should think about and behave toward one another, consistent with the entitlement of each to guide her activities in light of her own practical judgments. The market is one of these shared institutions, so its rules must also be consistent with mutual respect. This perspective "represents a fundamentally different way of thinking about economic life, a way that rejects both the view of economic actors as disconnected individuals in a state of nature (Lockeanism) and the view of economic actors as mere vessels of preference orderings that are inputs in a giant social welfare function (Utilitarianism)." Hussain argues that we need to formulate a deeper framework for thinking about economic life that can displace the family of moral ideas underpinning neoliberalism and finance capitalism. His book contributes to this wider project by working out the implications of equal citizenship for economic life, such that appropriately regulated markets and workplaces elicit respect for one another as free persons.

We would like to thank Waheed's many friends and colleagues who provided comments on the manuscript: Chiara Cordelli, Peter Dietsch, Andrew Franklin Hall, Joseph Heath, Louis-Philippe Hodgson, Martin O'Neill, Hamish Russell, Eric Shoemaker, Gabriel Wollner, two anonymous reviewers for Oxford University Press, our editor Peter Ohlin, and Waheed's department chairs, Martin Pickavé and Sonia Sedivy. We are especially grateful to Tina Ghosh for her support throughout this process.

Arthur Ripstein and Nicholas Vrousalis

Author's Preface

When I was in high school, I had a lot of menial jobs: cold calling people as a telemarketer, prepping cars at a car dealership, delivering Chinese food, selling clothes in a jeans store, and lots of others. One thing all these jobs had in common was a boss: someone told me what to do, and I almost always did what I was told.

One job I had was at a lunch counter. The assistant manager was a particularly mean-spirited young woman who basically yelled at me and made my life miserable. She tried to fire me a few times, but the manager kept me on—probably because I accepted the abuse. In any event, leaving the lunch counter one day, it dawned on me that almost everyone I knew had a boss. My mother had a boss. My father had a boss. My aunts and uncles had bosses. My neighbors, teachers, and friends had bosses. This seemed incredible to me. How could we live in a society that cared about freedom, and yet almost everyone spent most of their waking hours following orders? The whole thing seemed so unbelievable; I couldn't understand why people were going along with it.

At the time, I didn't have any clear ideas about how society worked. But if you had asked me, I think my intuitive idea was something like this: I answered to the assistant manager; the assistant manager answered to the manager; the manager answered to the regional suit; the regional suit to the head office suit; then there were a bunch of suits at the head office. The chain of command basically went up and up until there was a group of people at the top who told everyone what to do.

Fast-forward 10 years. After college, I went to work at an investment bank, with some of the same questions about authority in the back of my mind. The bank had large positions in several public-private ventures, mostly building airports and other public works projects. Part of my job was to listen in on conference calls where CEOs and CFOs would answer questions from other banks, hedge funds, and other institutional investors.

Here I felt I was looking at things from above. The executives on these calls were at the top of the hierarchies that I remembered from high school. They gave the orders to the suits, who gave the orders to the managers, who gave the orders to ordinary workers. The executives were giving orders, and ultimately they answered to us, the banks, hedge funds, and other institutional investors.

I realized quickly, however, that things were not so simple. The investment bank where I worked was not itself outside of the system: the bank also had shareholders, and our CEO and CFO had to get on conference calls every quarter, answering questions from the bank's institutional investors. Most of these institutional investors were also like us: they too had institutional investors with voting rights, and their executives too had to get on conference calls every quarter, answering questions from their investors. Even the private equity funds that did not have shareholders had to answer, at some level, to the investors who entrusted them with their money. The idea of a military-style hierarchy with a chain of command leading up to the ultimate decision-makers was too simple. Everybody had to answer to somebody: you could be demanding answers from some people in one meeting, and then be answering to some of the same people in the next. We were all enmeshed in something more sophisticated than a straightforward hierarchy.

Fast-forward another 10 years. After graduate school, I took my first job as an assistant professor at the Wharton Business School. There I taught classes to MBAs and sophisticated business undergraduates, and I came to understand the financial system at a higher level of abstraction. I could see that all of the people in the system I had been a part of were under pressure to make money. Every conference call was about money: shareholders wanted higher share prices, bondholders wanted more secure repayment, private investors wanted higher returns. Many people were making many demands, but really there was one underlying thing that everyone was asking for.

The pressure to make money itself unfolded within a deeper structure. This structure was more fundamental but more difficult to locate: the market. Not the financial market, but the *real* market, where real people make real things to sell to real people. All of the hierarchies and relations of authority that I knew from before were aimed at making money in the market. And in an important sense, these hierarches and relations of authority developed and persisted precisely because they kept people and resources moving in ways that were profitable.

The question that I started with was: How can we, as a society, be serious about freedom and yet allow a situation to persist in which most people spend most of their waking hours subject to the authority of another person? How can we reconcile a commitment to freedom with a vast system of daily subjugation? Once you abandon the naïve view of a hierarchy and appreciate how hierarchies can be part of a more impersonal system of social control, the question changes form. The question now is: How can we as a society reconcile our commitment to freedom with a social arrangement in which the market, along with the hierarchies that develop within it, plays a fundamental role in directing our lives? I think that a reconciliation is possible, but we have to think much more carefully about the relationship between markets and freedom.

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The Ethics and Economics Network in Europe and the Toronto Area Political Philosophy Workshop were important venues for working through new material. Thanks especially to Sandrine Blanc, Rutger Claassen, Peter Dietsch, Andrew Franklin-Hall, Kerah Gordon-Solmon, Louis Philippe Hodgson, Nien-he Hsieh, Michael Kessler, Hasko von Kriegstein, Rahul Kumar, Martin O'Neill, Julie Rose, Juri Viehoff, Andrew Walton, and Karl Wilderquist. For logistical and financial support, my thanks to the University Center for Human Values at Princeton, the Social Sciences and Humanities Research Council of Canada, the Department of Philosophy at the University of Toronto, and the Department of Legal Studies and Business Ethics at the Wharton School. Thanks also to the many audiences that heard this material at various talks and conferences.

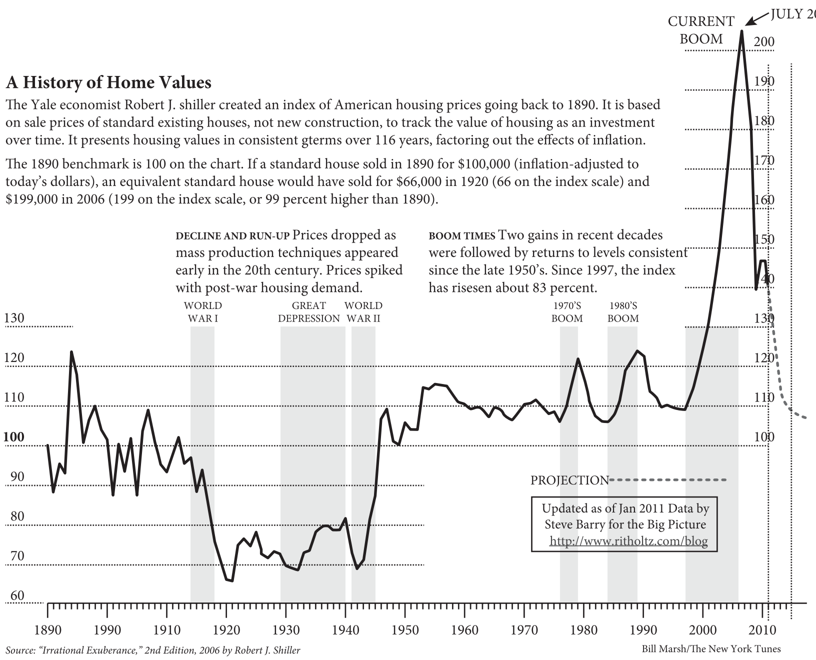
Words can't do justice to the people who kept my head above water, especially at the end of the writing process. Thanks to my doctors and nurses at the Johns Hopkins Hospital, Sibley Memorial Hospital, and Georgetown University Hospital. Thanks to my wonderful and caring friends: Steve Naplan, Puspa Mohanty, William Bryant, Joanne Liou, Steve Smith, Wendy Jastremski, Anthony Coleman, Paul and Laura Pirocanic, Rajib Chanda, Kathie Legg-Chanda, and Chi Leng. Thanks to my family: Dr. Sajida Hussain, Samira Hussain, Yusra Siddiquee, and my precious Afsi and Zayn. And thanks most of all to Tina Ghosh, the truest friend a person could ever hope for.

January 2021

Introduction

The market plays a central role in the lives of most people in the world today. One reason is that millions of people have money invested in stocks, bonds, houses, and other assets, so most everyone's financial future depends significantly on what happens in the market. But more important than this is the fact that the market represents one of our most important mechanisms of governance: the market plays a pivotal role in shaping how we live our lives.

Figure 1 presents Yale economist Robert Shiller's (2006) now famous chart of housing prices over the past 100 years.



What stands out, of course, is the huge run-up of home prices in the early 2000s and the collapse in 2006. The housing bubble was obviously an important financial event, one whose consequences many people are still

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feeling today. But the housing bubble was also an important social phenomenon: the bubble redirected huge stockpiles of raw materials from other worthy projects to the project of building new homes; it turned large stretches of uninhabited land into housing developments; it forced residents out of older neighborhoods to make room for new high-rises and condos; and it shifted thousands of workers from other fields into the housing sector. A vast social effort to increase the housing stock in the United States was essentially coordinated and directed by the market.

The market is, in effect, all around us, working all the time to guide us into certain jobs, certain investments, and ultimately certain ways of life. And when we see the market directing enormous resources and energies in ways that are unjustifiable in light of the underlying facts—as was the case in the housing bubble—we naturally question market governance; we may wonder whether we have made the right decision, handing such an important form of control over our lives to the market process.

I.1. Respect for the Value of Freedom

Economists and philosophers have done a great deal to address misgivings about the market, mainly by explaining how the market process tends to generate attractive results (Smith 1976; Hayek 1960; Mises 2012). Markets tend to draw us into a pattern of production activity and consumption activity that is efficient in the economic sense. An efficient pattern is one where there is no other feasible pattern of making things and consuming things that would use scarce social resources in ways that better satisfy people's desires and needs. This is, undoubtedly, an attractive feature of the market, and we have reason to value a market arrangement for this feature. But even those who agree that this feature is important may find that it alone does not address their misgivings. Among the most important misgivings is that having to do with freedom.

Imagine for the moment that we live in a system of government that concentrates power in the hands of a benevolent dictator D. Suppose that D's decisions sometimes seem arbitrary and irrational to us, but that he usually directs us to do things that are worthwhile. Although D may direct us in reasonable ways, we would be right to object to an arrangement that allows D to direct our lives unilaterally, without our being involved in the process in a meaningful way. After all, we have our own powers of reasoning and judgment, and even if a certain pattern of activity is a good one, this pattern should not be imposed on us in a way that bypasses our rational capacities. D's influence would be all the more objectionable if he were categorically opposed to explaining the reasons behind his decisions to us, the people whose lives are shaped by these decisions.

Market governance has some of the same features as a benevolent dictatorship. The market exercises a powerful and pervasive influence in our lives, leading us into certain patterns of production activity and consumption activity. But the market does not always involve us in the right way in generating these patterns, and it does not explain the reasons behind the patterns that emerge from the process. So even if the market tends to generate attractive patterns of production and consumption, critics are right to question whether market governance is consistent with a proper respect for the value of freedom.

I.2. Corporations and Corporate Executives

Many people feel the tension between market governance and freedom most viscerally in connection with business corporations. Corporate executives exercise a power to determine how people live their lives, and the scope of this power is often breathtaking. For example, along with a small cadre of executives and board members, Darren Woods, the CEO of ExxonMobil, commands the efforts of over 80,000 people employed by the company worldwide and controls assets worth over US$340 billion. These assets include refineries in 21 countries, which together produce more than 3% of the global supply of oil. Woods commands the efforts of 80,000 Exxon employees at work, and the pricing strategies and climate change policies that he adopts significantly shape the context in which everyone must act.

The power of corporations and corporate executives raises fundamental questions about the relationship between corporations and freedom. But in order to understand this relationship, it is important to situate corporations and corporate executives in the context of a broader system of governance. Woods has significant leeway to direct workers and to shape corporate policies as he sees fit, particularly in less competitive markets. But Woods is also subject to market discipline. If he chooses manufacturing strategies and corporate policies that are significantly at odds with market imperatives, ExxonMobil will lose market share. If he sticks to his guns, the company will face mounting losses and may eventually come to financial ruin. Bankruptcy would disperse the company's assets to firms more willing to adopt strategies and policies that are profitable. And so, in the long run, the market's dynamic tendency will be realized, whether through ExxonMobil or some other corporation, whether through Woods or some other corporate executive.

Corporations and corporate executives are powerful actors in society, and I will have more to say about them as such in later chapters. But it is important to see that these actors are also, to a significant degree, the handmaidens of the market, the instruments through which the invisible hand shapes and reshapes our lives.

I.3. The Relationship between Market and Freedom

This book is about the relationship between market governance and respect for the value of freedom. In an era of ever-expanding markets, economists and philosophers are right to draw attention to the signal merits of the market as a mechanism of governance. At the same time, critics are right to argue that market governance is in certain ways inconsistent with a proper respect for freedom. The view that I will develop, which has its roots in the work of Kant ([1797] 1996), Hegel ([1821] 1991), and Marx ([1867] 1967), says that a market arrangement respects the value of freedom in some ways but fails to do so in others, and that there are important ways that we can alter market governance to make it more consistent with this value.

Perhaps the most common view of the relationship between markets and freedom comes out of the classical liberal and libertarian traditions. Theorists such as Friedrich Hayek (1960), Milton Friedman ([1962] 1982), and Robert Nozick (1974) conceive of the importance of freedom in terms of the importance of an individual's control over her labor and property. Market governance respects the value of freedom, on this view, mainly because it accords each person the authority to decide for herself what she will do with her time and her possessions.

The problem with the property rights view, however, is that it does not appreciate the *systemic character* of markets. A market arrangement gives each person control over her labor and property, but the options that are open to her in virtue of these forms of control are powerfully shaped by external forces. Imagine, e.g., that a particular individual finds that her control over her labor power opens up certain options for her in the automotive industry.

These options exist, in part, because consumers have certain preferences. If consumer preferences change, the market process may scale back her options in the automotive industry and expand her options elsewhere, perhaps in the healthcare sector. At a certain point, these gradual changes in her option set will move her from one way of life to another. When the market process moves her in this way, it plays an important part in the determination of her conduct. You might say that the market process is like a scientist in a lab, opening and closing doors to lead mice through a maze: it shapes people's lives without necessarily overruling their authority over their labor and property.

Another view of the relationship between markets and freedom focuses on the power to choose from a wide range of options. We sometimes think of freedom in terms of consumers having the power to choose among a wide range of products, investors having the power to choose among a wide range of investments, and workers having the power to choose among a wide range of job opportunities (see, e.g., Sen 1999).

The choice-centered view has significant merits, but it also suffers from a failure to appreciate the systemic character of markets. A social arrangement that provides individuals with a diverse range of options to choose from may nonetheless embody a form of social control over people's lives. It may do so if the arrangement manages people's option sets in such a way as to generate and maintain a certain overall pattern of activity in society. Consider a system of traffic lights in a city. A green light opens up a set of options for a driver; a red light closes them off. If a computer program controls the lights in a city, it can generate and maintain a certain pattern of driving activity—e.g., a traffic jam—by constantly funneling drivers toward a few main streets. Drivers would always have more than one option open to them at intersections, and as drivers each make their choices, they might think that the overall pattern is simply a product of their private choices. But in fact, the pattern is substantially the product of the program that manages the lights.

Much like a system of traffic lights, prices in a market arrangement can change the option sets open to individuals in such a way as to draw everyone into a certain pattern of production activity and consumption activity. Individuals may think that the overall pattern is simply a result of their private choices as consumers, workers, and investors, but the pattern is importantly shaped by the market arrangement.

The key point here is that a market arrangement is a mechanism of social control. When members of a community adhere to the requirements of the arrangement, they take part in an enterprise that draws individuals into a certain pattern of conduct—i.e., an efficient pattern of production and consumption—and maintains the pattern. Moreover, the arrangement draws individuals into the pattern without regard for the private judgments of individuals about the pattern. An arrangement that bypasses individual judgments to maintain a certain pattern may or may not be consistent with an appropriate respect for freedom. But the property rights view and the choice-centered view both lack the resources to bring the problem into focus.

I.4. The Anti-authoritarian Dimension of Freedom

The correct view focuses instead on what I call the *anti-authoritarian ideal*. This ideal takes as its starting point the fact that a market arrangement is a mechanism of social coordination, an institutional arrangement that is structured so as to draw members of society into certain patterns of activity. Respect for the value of freedom requires that a social coordination mechanism should be consistent with citizens respecting themselves and one another as free persons, each entitled to guide her activities in light of her own practical judgments. When a coordination mechanism is structured so as to maintain a certain pattern without an appropriate concern for the private judgments of individuals about the pattern, it is *authoritarian* and violates the requirements of the ideal.

An important feature of the anti-authoritarian dimension of freedom is that it has a complex structure that allows for social coordination mechanisms to rely, in certain cases, on judgment-bypassing forms of social control. These forms of control are consistent with the ideal when citizens face limitations that would prevent them from drawing themselves into a rational pattern of activity on their own. Given the limitations in citizens' rational capacities, a social arrangement is consistent with the anti-authoritarian ideal if (a) the arrangement draws citizens into the most rational or choice-worthy pattern of activity; (b) the arrangement enables citizens to judge for themselves the merits of the pattern; and (c) the arrangement gives citizens a rational basis for trusting that the arrangement is drawing them into the most rational pattern of activity.

Let's assume that coordinating the overall pattern of production and consumption in a large political community is an extremely complex and time-sensitive enterprise, and that citizens could not realistically hope to organize and reorganize themselves in rational patterns on their own. A market arrangement is consistent with the anti-authoritarian ideal mainly insofar as it draws citizens into attractive patterns of production and consumption activity in this context. Suppose that the market leads someone to the healthcare sector by scaling back her options in car manufacturing. Suppose that it does so in response to a change in consumer preferences. If the underlying needs in society have changed, then there may be greater reason to adopt a pattern in which the individual works in healthcare rather than in car manufacturing, and so the market process guides society toward the most attractive pattern, all things considered.

On the other hand, one of the central weaknesses of market governance is a lack of transparency: the market does not reveal to people why they should perform the tasks that it directs them to perform. If the market guides someone into healthcare by scaling back her options in car manufacturing, it does nothing to explain to her why it is moving her in this way. Has there been a change in consumer preferences? Have new technologies changed relative efficiency? Are unfair trade practices behind the shift? The arrangement does not give the individual any account of the underlying reasons that justify this new pattern of activity, so it does not put her in a position to *participate* in the pattern on the basis of her own practical judgments.

I.5. Intermediated Capitalism

Reason-sensitivity and transparency are central to the anti-authoritarian ideal, and these ideas point to a program for improving market governance. Many countries in Europe have economic institutions that rely significantly on democratic forms of intermediation to help coordinate their economy. These institutional arrangements belong to the broader family of market-based systems, but they structure and temper market governance in ways that are different from an American-style arrangement.

Take Germany, for example, the economic powerhouse of Europe. Germany has a market economy, but its institutions are different from those in the United States. Under the German "codetermination" system, industry-wide unions have a seat on the supervisory boards of large corporations, such as Daimler and Siemens. Moreover, these industry-wide unions participate in various industry-level rule-making forums, alongside encompassing associations that represent shareholders. The various elements of the codetermination system allow the representatives of labor to work alongside the representatives of capital in understanding and shaping patterns of production (and consumption) in society.

The anti-authoritarian ideal says that the European model of market governance answers better to the value of freedom than the American model. Democratic intermediation improves the reason-sensitivity of the market process by making it more sensitive to the reasons that workers have for participating in certain forms of production. At the same time, collaborative reasoning, deliberation, and monitoring help to disperse information, making clearer to workers how various changes track or fail to track the relevant underlying considerations. These measures improve transparency. The codetermination system is a model for respecting freedom in market societies, and I will argue that we should develop the model further to address the facts of globalization.

I.6. Displacing the Neoliberal Outlook

A deeper motivation for this book has to do with our current thinking about economic life. Our political culture today tends to view economic life through a lens shaped by a family of Lockean ideas about private property and Utilitarian ideas about social welfare. These ideas are not always clearly articulated or fully coherent, but they serve as the background for various arguments in favor of neoliberal policies that treat finance capitalism as "perhaps the most beneficial economic institution known to human kind" (Rajan and Zingales 2003).

Although there are good arguments that you could make for codetermination from within the broader outlook that informs neoliberalism, these arguments could never form the basis for a stable political consensus in support of codetermination on their own. This is because the deep moral appeal of codetermination draws on an outlook that is fundamentally different from both Lockeanism and Utilitarianism.

The deep moral appeal of codetermination flows from a broadly Kantian perspective on economic life.[1] On my view, economic actors are members of

[1] Kant himself does not view economic life this way: he conceives of the market mainly as a system of private property, not an institution that creates the conditions for our production activities and consumption activities to form a dynamical system. Later writers developed Kant's ideas in this direction; see Hegel ([1821] 1991), Marx ([1867] 1967), Habermas (1996).

a political community. Shared social institutions define a framework for how members of the community should think and act toward one another. And this shared framework must be consistent with citizens respecting themselves and one another as free persons, each entitled to guide her activities in light of her own practical judgments. According to the Kantian perspective, the market is one of these shared institutions, so its rules must also be consistent with mutual respect as free persons. The Kantian perspective rejects the idea that we can treat each other as mere tools or machines in economic life, so long as our political institutions are properly structured to embody mutual respect in the democratic process. In this way, the Kantian perspective represents a fundamentally different way of thinking about economic life, a way that rejects both the view of economic actors as disconnected individuals in a state of nature (Lockeanism) and the view of economic actors as mere preference orderings that are inputs in a giant social welfare function (Utilitarianism).

The Kantian perspective helps us to understand the intuitive appeal of codetermination, and in doing so it serves an important political purpose. In order to formulate the basis for a stable, long-term political consensus in support of codetermination, something that we find in the German-speaking countries in Europe, we need to articulate this underlying perspective as clearly as possible. We need to formulate a deeper framework for thinking about economic life that can displace the family of moral ideas that underpins finance capitalism as we know it. This book contributes to the wider project by working out the implications of the idea that even in economic life we are citizens in a political community who must respect one another as free persons.

I.7. The Plan for the Book

Chapters 1 and 2 set out a framework for thinking about normative issues in economic life. The "institutional perspective" stresses the importance of social institutions and public values in thinking about these questions, and it provides us with an important basis for rethinking certain misleading contemporary approaches to the public-private distinction.

Chapters 3 to 6 are the heart of the book and set out a new conception of the relationship between markets and respect for the value of freedom. The first idea is that an advanced market economy is a coordination mechanism.

When members of a political community adhere to the requirements of the arrangement, their production activities and consumption activities form a dynamical system, one that constantly adjusts and readjusts to changing circumstances in order to maintain a pattern that is economically efficient (i.e., Pareto optimal). The process of adjustment works through prices, which constantly change the option sets open to individuals so as to draw them into efficient patterns. But these changing option sets draw individuals into patterns in a way that bypasses their private judgments about the merits of these patterns.

Chapters 4 and 5 present a theoretical account of a moral defect that coordination mechanisms may exhibit when they maintain patterns through a judgment-bypassing process. This defect is authoritarianism. Social coordination mechanisms may be authoritarian when they rely on a judgment-bypassing process to maintain a certain pattern in social life. Drawing a parallel between political authority structures and market coordination, these chapters explore the restricted circumstances in which a judgment-bypassing coordination mechanism may be justified.

Chapter 6 assesses an advanced market economy in terms of the anti-authoritarian ideal. I argue that an advanced market economy does not satisfy the requirements of reason sensitivity, transparency, and trustworthiness as a stand-alone mechanism. Moreover, even a liberal market democracy that embeds an advanced market economy in a more complex regulatory process and legislative process fails to satisfy the three requirements.

Chapter 7 elaborates the theory laid out in chapters 3 to 6 to address normative questions about the business corporation. Many theorists think of business corporations as stand-alone authority structures on the model of the state (e.g., McMahon 1994, 2013; Ciepley 2013; Anderson 2017). According to the "dynamical view" of the business corporation, corporations come together and break apart as part of the market coordination process; they are properly understood as vehicles that help the price system to maintain an overall pattern of production and consumption in society that is economically efficient. Moral subordination in a market society is, significantly, subordination to this impersonal process. And when we think about the right way to structure an advanced market economy, we should think about the internal authority structure of business corporations and various features of corporate law as parts of a wider coordination mechanism that must satisfy the three requirements.

Chapter 8 lays out a model for how an advanced market economy could be structured so as to satisfy the anti-authoritarian ideal. *Intermediated capitalism* is a market arrangement that has all the features of an advanced market economy but also incorporates deliberative rule-making mechanisms at the level of firms and industries to improve rationality and transparency and to give citizens a greater basis for trusting in the market process. The codetermination system in Germany has certain features—such as representative rule-making at the level of the corporation—that answer to the model, and the chapter appeals to the German example to illustrate the idea.

Over the course of these eight chapters, some readers may find themselves wondering at times what exactly a market economy is—or at least what exactly *I* think it is. For the most part, contemporary political philosophy operates with a somewhat vague conception of a market economy, but a more precise view is necessary to address certain issues. Rather than clutter the main argument with a pedantic definitional chapter, I have included an appendix that lays out the conception of a market economy that informs the argument of this book.

A key element in the conception is mutual disinterest. A market economy, on my view, is an arrangement that requires (not simply permits) agents to act in a mutually disinterested fashion. This requirement is formalized in US antitrust law and European competition law, which both legally require market actors to act in a mutually disinterested fashion—sometimes on pain of criminal sanctions. A market arrangement would be less likely to generate efficient outcomes if economic actors systematically violated the requirement of mutual disinterest, so insofar as the justifying rationale for a market economy is economic efficiency, we should understand mutual disinterest as a requirement of the institution (not just a permission).[2] If at some point in reading the main argument, you find yourself wondering what exactly a market economy is, turn to the appendix and consider one attempt to be rigorous about the nature of this fundamental institution in modern social life.[3]

[2] A market arrangement would be less likely to generate efficient outcomes if economic actors systematically violated the requirement of mutual disinterest. One type of problem has to do with information: if A knows best what is in A's interest and B knows best what is in B's interest, then a situation in which A and B each spend some of their time pursuing the other's interests would likely generate an outcome that is Pareto inferior to the one that results when they are each purely self-interested (see Sen 1984b).

[3] [Chapter 8 discusses eight conditions for an advanced market economy. Hussain's working definition is: "a basic bargaining system whose rules are structured to create a society-wide mechanism of social coordination, one that shapes social patterns of production and consumption."—Eds.]

1

The Institutional Perspective

In order to think clearly about the relationship between markets and freedom, it will help to have a broader framework for thinking about normative questions in economic life. In this chapter, I will set out the main elements of what I call the *institutional perspective*, a view of economic life that stresses the importance of social institutions and public values. The main elements of the institutional perspective are, I believe, widely endorsed among philosophers, political scientists, and legal theorists, though the view is often assumed in the background rather than articulated in explicit terms.

One reason I want to set out the institutional perspective explicitly is that doing so is essential to a proper understanding of the public-private distinction. In recent years, philosophical discussions have come to treat the market simply as an arena in which individuals with private property interact with other individuals with private property. The institutional character of the powers of private ownership and exchange are seldom acknowledged or properly theorized.[1] As a result, many philosophers take it for granted that the liberal ideal of a sphere of freedom for private individuals rules out most limitations on market powers of ownership, beyond whatever limitations are involved in redistributive taxation.

In order to think clearly about the merits of different economic arrangements, however, it is important to understand that the liberal commitment to a sphere of freedom for private individuals does not imply a commitment to the full range of institutional powers commonly associated with private ownership and exchange in market societies. Among the central insights of sophisticated liberal thinkers, such as John Stuart Mill (1906, 1994), John Rawls (1993a), and G. W. F. Hegel ([1821] 1991) is that the liberal ideal is compatible with a wide range of institutional arrangements, including arrangements with very different economic systems and systems of property. Mill and Rawls are explicit that the liberal ideal may even be compatible with

[1] A notable exception is Murphy and Nagel (2004).

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a socialist regime where productive assets are collectively owned (Mill 1994; Rawls 1993a, 1999; cf. Taylor 2014).

My point here is not to argue for socialism but to put us in a position to think clearly about market coordination by showing that the liberal ideal is not the central issue in understanding market arrangements. In chapter 2, I will make the case for what I call the *indifference thesis*, which states that the liberal ideal of a sphere of freedom for private individuals can be satisfied in social orders with very different economic arrangements, so disagreement about the merits of these arrangements does not turn on disagreements about the importance of the liberal ideal. Once we see that the liberal ideal is not what is at issue, we can think more clearly about how economic arrangements must answer to other moral concerns.

1.1. Social Institutions

Let me begin with some general observations. Most of us live in reasonably stable societies, where millions of people interact with each other every day in a generally peaceful and productive way. Peaceful and productive interaction on this scale would be impossible without large-scale social institutions.

A *social institution* is an abstract scheme of rules (and sometimes principles) that specifies how members of a group should think and act, where each member of the group has an obligation to adhere to the scheme in part because the other members are adhering to it as well (Hart 1997; Dworkin 1986; Rawls 1999, 293–308; Scanlon 1998, 339–40; see also Habermas 1984, 1996). When I am driving around a parking lot trying to park my car, e.g., the other drivers and I typically share an understanding of where people may park their cars and who has the right of way. There are many fair and appropriate ways of organizing interaction in a parking lot, so part of the reason each of us has an obligation to adhere to the shared scheme is the fact that the others are adhering to it as well.[2]

[2] How does generalized adherence to a rule structure in a group create an obligation on individual members to adhere to the rules? There are several prominent arguments in political philosophy. For example, (a) the "principle of established practices" (Scanlon 1998, 339–40) says that when some rule structure is necessary to govern an activity and a number of different structures would do this in a justifiable fashion, then the fact that one of these structures is generally accepted in the group privileges the scheme and makes it wrong for members to violate the scheme simply because it is convenient for them to do so; (b) the "natural duty of justice" (Rawls 1999) says that when there is generalized adherence to a rule structure in a community and the structure satisfies the principles of justice, then individual members have a duty to (among other things) adhere to the requirements of

The rules of an institution typically define various statuses, with rights, duties, and powers attached. They determine how people acquire and lose the statuses defined, and they may specify the grounds on which people may legitimately exercise institutional powers (Hart 1997, 27–42; Scanlon 2003, 43–4). The rules of a parking lot, e.g., will typically define statuses such as "the occupant of spot #23," where having this status gives the status holder certain exclusive rights to park in that spot. The rules define procedures that determine how people can change who is "the occupant of spot #23" (e.g., by driving in or out of the spot in the right way). And the rules specify how certain institutional powers may be exercised; e.g., the rules authorize patrons to occupy a parking spot for reasons connected with their own personal use of it. But the rules in most parking lots do not authorize patrons to occupy a spot simply for the purposes of extracting monetary concessions from other patrons who might want to park there.

Among the various institutional powers that an institution can define, some are rule-making and rule-enforcing powers (see Hart 1997, 95–8). Among the various statuses that an institution may define, some come with institutional powers attached that allow the status holder to change the rules of the institution or to make official judgments about conformity with the rules and impose rule-defined sanctions for noncompliance. In many parking lots, the rules will define an office of "parking attendant." This office comes with certain rule-making and rule-enforcing powers attached, and these powers enable the person holding the office to change the rules of the parking lot, to make new rules over time, and to impose fines on rule-breakers.

1.1.1. Complex Institutions

For the most part, the institutions that will be my main concern in this book are value-oriented systems, or what I will call *complex institutions*.

the rules as these apply to them; (c) when members of a group each enjoy certain benefits in virtue of members adhering to a certain rule structure, voluntary acceptance of the benefits of other people forgoing opportunities to adhere to the rules creates an obligation of fairness on each member to similarly forgo other opportunities to adhere to the rules (see Hart 1984 [1955]); (d) members may have an "associative obligation" to adhere to the scheme because it embodies a more abstract form of fraternal concern that is required among the members of the group (see Dworkin 1986). The precise nature of the individual obligation to adhere to the rule structure is not as important for my argument as the basic fact that widespread adherence can create an obligation.

A complex institution consists of an abstract scheme of (a) rules that define various rights, duties, powers, statuses, and procedures and (b) "organizing principles" that specify a certain public justifying rationale for the enterprise. Within the framework of practical reasoning that constitutes a complex institution, members regard the more specific requirements of the institution as elements of the scheme insofar as these elements work together to realize the specific justifying aims or objectives set out in the organizing principles (Rawls 2001, 137; O'Neill 1985; see also Dworkin 1986; Scanlon 2003; Habermas 1996; Hegel [1821] 1991). Particular requirements are understood in light of the justifying aims, and new requirements may be implied in new contexts because they are required to achieve these aims. In the usual case, the organizing principles of a complex institution are widely understood but not necessarily part of the ordinary reasoning of most participants. These principles typically form part of a public system of reasoning that provides authoritative guidance to officials as they exercise their institutional powers to manage the institution and to develop its rules over time.

In the case of a parking lot, the rules define various statuses—e.g., "occupant of spot #23"—with rights, duties, and powers attached. The rules define various procedures that determine how drivers can affect their own and one another's statuses. But most parking lots are complex institutions, where certain organizing principles set out a public justifying rationale for the enterprise. Usually this justifying rationale is to facilitate the safe and efficient use of the parking lot for the purpose of parking cars. Everyone understands that the point of the various statuses and procedures defined by the institution is ultimately to maintain a safe and efficient pattern of parking activity, and the justifying aims of the institution inform how specific requirements should be understood and have implications for the requirements of the institution in new contexts.

Drivers in a parking lot are not usually required to think about the public justifying rationale for the enterprise when they are looking for spots. The organizing principles are rather part of an authoritative system of public reasoning that guides institutional officials. When the parking attendant confronts new circumstances—e.g., people occupying spots for tailgating parties—she will cite the safe and efficient use of the lot for parking cars as a principle for developing rules and policies for these new situations.

1.1.2. Two Standpoints

Another feature of social institutions that will become important in later chapters has to do with different standpoints from which to think about these arrangements. There are two fundamental standpoints from which to think about a social institution, much as there are two fundamental standpoints from which to think about human action in general.

Take the case of a game such as volleyball. One way to look at the game is from the standpoint of an *observer*. When you watch a group of people playing volleyball, the game is an observed pattern of behavior in the world, a pattern guided by a shared understanding among the players about the rules and organizing principles of the game.

But another way to look at the game is from the standpoint of an *agent*. When you and your friends are trying to decide how to spend your afternoon at the beach, you do not look at volleyball as an observed pattern of behavior in the world. You look at the game as an objective scheme of rules and organizing principles that you and your friends might collectively adopt to guide your thought and conduct for the afternoon. From the practical point of view, the game is not an observed pattern of conduct but a kind of normative structure that specifies how you and your friends should think and act. To use a Kantian term, the game is a "collective maxim," a set of rules and principles that members of a group may adopt as an authoritative guide for their thought and conduct.[3]

The distinction between the two standpoints is something that holds not just for games but for social institutions in general. In the case of a parking lot, we can take the observer's perspective, where the parking lot is a pattern of activity among the drivers, guided by a certain shared understanding among them about the rules and principles of the lot. But we can also take the perspective of an agent, a driver who is driving around the parking lot, treating the rules and organizing principles as a guide for how she and the other drivers should think and act.

The distinction between the two standpoints will be important when we turn to the moral assessment of social institutions. On my view, when we assess institutions from the moral point of view, we assess them, in the first instance, as practical proposals. We assess institutions as objective schemes

[3] See O'Neill (1985, 122); see also Rawls (2001, 137) on the "ideal description" of an institutional regime.

of rules and organizing principles that may serve as the content of a shared understanding among the members of a group about how they should think and act, where each member has an obligation to adhere to the scheme in part because the others are doing so as well. There are many different properties that make institutions more or less appropriate as a guiding framework, and one such property is the *moral soundness* or *defectiveness* of an institutional arrangement. I will have more to say about these issues in chapters 4 and 5.

1.2. Social Order in a Modern Society

The social order in a modern society consists of a wide array of large-scale institutions, such as the family, the law, property, and a system of government. Each of these complex institutions consists of a scheme of rules and organizing principles that is the object of a shared understanding among members about how people are supposed to think and act in various circumstances.

I want to stress that in a modern society, such as our own, major social institutions are, at the most fundamental level, *impersonal* normative structures. The most basic normative requirements of these arrangements are not enacted by any particular individual or authority figure. As H.L.A. Hart (1997) correctly observes, the most fundamental rules in a modern social order are not "orders backed by threats" and may not be issued by any rule-giver at all. Take the most basic constitutional rules that define the legislative process and various branches of government in the United States or Canada. These rules define a political authority structure that consists of various offices that individuals may occupy—e.g., "president," "prime minister," "senator." When the individuals occupying these offices act in an official capacity to make legal rules, they exercise powers within the authority structure to enact these rules. But the rules of the authority structure *itself* are not rules that these officials enact; these rules normatively precede the official acts of the officeholders and confer certain powers on these individuals. The institutional order stands behind various acts of legislation and authoritative enactment, so the order itself is not enacted by any particular individual or authority figure.

We sometimes think of institutions as social conventions, but institutions are not necessarily formal arrangements whose requirements are exhaustively spelled out in a publicly recognized code of conduct. Members of a community may seek to establish a more explicit, public understanding of the requirements of an institution in certain cases, but this is not essential and may not always be possible. For example, the nuclear family is an important social institution, and in contemporary Western societies we have a shared understanding of how people must act when they act as "fathers," "mothers," "brothers," "sisters," etc.[4] But the shared understanding of family roles does not take the form of a set of publicly declared rules that everyone in the community explicitly accepts.

From the practical point of view, we sometimes face questions about what exactly adherence to the rules and principles of an institution involves. That is, it may not be clear what the rules and principles of an institution demand of us. Following Ronald Dworkin (1986), I take it that the most important institutions in a modern social order incorporate some structural recognition that their requirements are open to interpretation. In the usual case, members of society have a shared intuitive understanding of how they are supposed to think and act, say, in a parking lot. When disagreements arise about what the institution requires, members engage in interpretive reasoning to settle these disagreements: we formulate a more formal account of what the institution requires and offer some interpretive argument to show that this account is correct. It is most characteristically in these discussions that we articulate institutional requirements in terms of explicit rules (e.g., "Drivers must park between the white lines") and organizing principles (e.g., "The point is to ensure the safe and efficient use of the lot for parking cars"), where the rules and principles together serve to make sense of our shared practices.

Institutions are obviously an important part of social life, and we often rely on institutional rules, organizing principles, and interpretive reasoning to coordinate our interactions. But it is worth emphasizing that in a modern society, members are also capable of reflecting critically on their social institutions. In critical reflection, members bring the requirements of the institution into view by offering an interpretation of the rules and principles, and they assess the arrangement in terms of values and ideals that are not themselves internal to the institution (Habermas 1984, 1996;

[4] Part of the reason why we have an obligation to adhere to the requirements of the shared understanding of these roles is that other members of families and other members of the community more generally are adhering to its requirements. For instance, if other children in the community are being cared for by their "mothers" and "fathers," then my wife and I may have an obligation to care for a certain child because we are the child's "mother" and "father," and no one else would take care of the child if we don't.

Dworkin 1986). Members may take a critical perspective on family life in our community or the political system and argue that these arrangements are objectionable in their current form because they are inconsistent with institution-independent values such as fairness or equality.

Given the possibility of critical reflection, there is an important set of questions in political philosophy and legal theory about how to characterize the attitude that members of a society have toward the requirements of their major social institutions. For my purposes, it is not necessary to answer all of these questions here. I only note that in any well-functioning society, members treat the major elements of their institutional order as at least presumptively legitimate. Members will typically comply with institutional requirements and cite these requirements when they disagree about the correctness of one another's conduct. Moreover, when one member cites the requirements to another, she does not do so expecting that the other will comply simply out of fear of punishment or hope for long-term personal gain.[5] Members cite the rules, at least in part, with the expectation that other members see that they have an obligation to comply with the rules (even if the rules are not ideal). Everyone in society may, of course, examine the presumption of legitimacy and ask whether they do, in fact, have an obligation to comply. But no social order can survive over the long run unless its rules and organizing principles are part of some at least partial or overlapping normative consensus on deeper values and ideals (see Rawls 1993c; Habermas 1996).

1.3. The Public-Private Distinction

Most of this book will be concerned with normative questions that arise in a liberal democracy. We can think of a liberal democracy as a society with a certain ideal-typical arrangement of basic institutions. This is the arrangement characteristic of contemporary societies such as the United States, Canada, the United Kingdom, Germany, and France. The most salient feature of a liberal democracy for my purposes is the division of social life into two normative domains: the *public* and the *private*.

[5] This is not to deny that punishment, and cost to long-term self-interest are important for the purposes of stabilizing compliance (see Sen 1984a; Williams 1995). There is also an important role for nonrational forms of normative commitment to play in securing compliance (see Habermas 1996, chapter 1).

Like other modern societies, a liberal democracy has a legal system (Hart 1997; Habermas 1996, 17–41, 132–93; Dworkin 1986). This means that there is a shared understanding among members that certain rules in society are legal rules and that these rules have a privileged normative status in the community. Various mechanisms allow members to make and change the legal rules, such as an electoral process, a legislative process, and various regulatory and judicial proceedings. In each case, there are offices with rule-making powers attached, and officeholders can use these powers to make, change, or elaborate the legal rules in some way. Among other things, a legal system allows members of a community to formalize and manage the institutional arrangements that make up their social order.[6]

In a liberal democracy, members act in a *public capacity* when they occupy offices that give them some legally defined power to make, change, or elaborate the legal rules—e.g., when they serve as officials in government agencies, judges in courts, district attorneys, representatives in the legislature, or voters in elections. When members act in a public capacity, the rules of the social order typically do not allow them to exercise their powers on the basis of considerations that stem from their own personal goals, plans, and projects. The rules require them instead to exercise these powers on the basis of considerations stemming from widely shared ideas in the community about public values.

Suppose that an official with the UK National Health Service (NHS) must decide whether to include a certain drug on the list of approved treatments that will be covered by public funding. The rules of a liberal democratic social order would not permit her to approve or disapprove of the drug simply

[6] Having a legal order is important because it allows members of a community to collectively manage the various components of their institutional order (Hart 1997). Among other things, (a) a legal order allows members to authoritatively state and enforce the rules of subordinate social institutions; (b) a legal order allows members to change both the first-order obligations and the institutional powers defined by subordinate institutions; and (c) a legal order allows members to create new institutions and to manage the interaction among various subordinate institutional arrangements.

In some societies, the legal formalization of an institution may be quite different from how the institution actually operates in practice—e.g., in some racially segregated societies, the legal rules of private ownership may be formally identical for different racial groups, but the actual implementation of these rules will vary greatly for different groups. In these cases, what matters from the standpoint of the institutional perspective is the actual scheme of rules and principles that coordinates social life in a community. If the legal formalization does not actually serve as the coordinating rules for social life, then the institutional perspective would focus on the underlying, nonformalized rules and principles that actually serve as the coordinating rules. The moral soundness or defectiveness of these nonformalized institutions would then serve as the basis for determining the duties of citizens to adhere to the rules, campaign against the rules, engage in civil disobedience, and so on (see chapter 4).

because doing so would advance her own personal goals and objectives (e.g., because a drug company offers her a bribe). The rules require her to make these decisions based on certain standards set out in the law. These legal standards are themselves the product of a complex legislative process that includes both formal decision-making in the legislature and informal political deliberation among citizens in the public sphere (Mill 1991; Habermas 1996). The wider process of deliberation in the public sphere must typically reach some degree of consensus before legislators take action, so when an official at the NHS makes a decision to approve or not to approve of a drug based on the legal guidelines, she is effectively implementing rules that embody widely shared (though, of course, not universally accepted) ideas in the community about how society should be organized.

Let's call the sphere of social life in which members act in a public capacity the *political sphere*.[7] In human history, there have been examples of societies where members were almost always understood to be acting in a public capacity. But a key feature of a liberal democratic social order is that the political sphere does not pervade the whole of social life (Hegel [1821] 1991; Mill 1906; Rawls 1999; Dworkin 1977; Habermas 1996). A liberal democratic social order defines a sphere of social life in which members do not act in a public capacity but act as private individuals. In this sphere, members have various institutional powers, but the institutional order permits them to exercise these powers on the basis of a wide range of considerations that flow from their personal goals, plans, and projects. These considerations need not be tied to any widely shared ideas about a properly ordered society. Call the sphere in which citizens have institutional powers that allow them to live separate lives that answer to their personal conceptions of the good the *civil sphere*.

We come now to a centrally important aspect of what I am calling the *institutional perspective*. In the civil sphere, citizens have various institutionally defined powers that they may exercise on the basis of their own personal goals, plans, and projects. This is a domain in which they can each live separate lives as private individuals. But according to the institutional perspective, the civil sphere is not a Lockean state of nature. *It is an institutionally defined arena for social interaction* (Hart 1997, 27–42; Rawls 1993b; Hegel [1821] 1991; Durkheim 1984). The civil sphere is a complex domain in which

[7] The political sphere corresponds roughly to the domains of social life that Hegel ([1821] 1991) has in mind when he uses the terms "the police," "the courts," and "the state."

there are many different institutions, each of which defines various powers that citizens may use to organize their affairs in light of their personal goals, plans, and projects.

Marriage is a good illustration. In liberal democracies such as the United States, Canada, and the United Kingdom, marriage is a legally formalized institution. The legal system provides citizens with the legal power to enter into marriage relationships, and the system carefully defines the consequences of doing so. Marital status can determine who will inherit valuable assets, who has the authority to make certain end-of-life decisions, and whether the state can compel individuals to testify in a criminal trial. The law also sets out the reasons that constitute legitimate grounds for exercising the power to enter into a marriage (see Durkheim 1984, 155–8). In the United States, if a person enters into a marriage relationship for the purposes of evading immigration laws, the relationship does not constitute a valid marriage for the purposes of pursuing permanent residency and citizenship. In effect, when people base their decision to marry on certain types of considerations, their conduct does not produce a relationship that has the full legal significance of a marriage.

What makes the institution of marriage part of the civil sphere, on my view, is the way that individuals are licensed to exercise the powers that it defines. The rules of marriage in most liberal democracies do not require citizens to make marriage decisions as if they were public officials acting in a public capacity. As a private individual, the institution allows me to exercise the power to enter into a marriage based on a wide range of considerations, such as love, sex, and compatibility. So even if it is true that I could help to break down certain pernicious patterns of racial segregation in society by pursuing certain types of marriage partners, the institution permits me to make a decision based on other types of consideration.[8]

As I understand it, the basic conceptual distinction between the "public" and "private" domains corresponds to the distinction that I am drawing between the political sphere and the civil sphere. The two realms differ mainly in the types of considerations that the institutional order regards as legitimate grounds for exercising various institutional powers and forms of authority. Keep in mind that I have not said anything yet about what forms of power and authority properly belong in the political sphere and what forms properly belong in the civil sphere. There are many important questions to

[8] People may choose to form marriage associations to break down racial barriers if they want; my point is simply that they are not required to do so.

ask about the proper scope of each of these domains, and I will address some of these questions in the next chapter.

It is worth taking a moment to highlight the significance of thinking about the basic conceptual distinction between the public and the private in the way that I have described. The public-private distinction corresponds, on my view, to a distinction between two institutionally defined domains, where people are licensed to exercise institutional powers differently in each one. The view that I have outlined contrasts with a popular view of the distinction that implicitly or explicitly stresses the importance of private property. Many people in the United States and Canada think of private life as a domain in which people are free to do whatever they want within the boundaries set by their property rights and basic legal constraints on force, fraud, etc. So, e.g., if two individuals are acting in the privacy of their own home, they should be free to engage in whatever consensual activities they choose, so long as their activities do not affect anyone else in society.

Though the property rights view is widespread, it is highly misleading. We may agree with the popular view that people acting in their own homes, not bothering anyone else, should have the legal authority to engage in a wide range of consensual acts as private individuals. But it is far from obvious that this has anything to do with private property. After all, consensual acts among individuals who rent or lease a house from an owner are "private" in a similar sense, and most of us would agree that renters and leasers should have a similar authority to engage in consensual acts in their regular abode (see Radin 1993, 56–63). Similarly, the decisions of homeless people to enter into marriages or to form religious associations are "private" in the sense that homeless people should have the legal authority to make these decisions as private individuals, yet again this has nothing in particular to do with private property.

More generally, the property rights view paints a misleading picture of the civil sphere. Private property is an important institution, but there are many other important institutions in the civil sphere. Among these, we might include marriage and the family, organized religion, scientific inquiry, primary and secondary education, universities, sports, healthcare, professional ethics, traffic codes, courtesy, dating, gender norms, conversational truth-telling, lining up at a water fountain, etc. Each of these institutions consists of a shared understanding about how people should think and act in certain contexts, an understanding that typically defines (a) statuses with rights, duties, and powers attached; (b) procedures that determine how people acquire and lose these statuses; and (c) organizing principles that set out a justifying rationale for the enterprise. There is no reason to think that private property takes precedence over all of the various institutions that serve important functions in the civil sphere. (More on this below.)

1.4. An Advanced Market Economy

Our social order consists of a complicated scheme of institutions that specify how citizens should think and act in various circumstances. My main concern in this book will be a particular institutional scheme, one that many societies have adopted for structuring economic life. The scheme in question is an "advanced market economy," the ideal-typical scheme that orders economic life in liberal democracies as we know them today.

Start with a more basic idea. A market is a legally articulated social institution (Rawls 1993b, 1999; Durkheim 1984). In a liberal democracy, the law will sometimes provide citizens with the legal power to "buy" and "sell" objects, and it will carefully define the consequences of these legal maneuvers. Suppose, e.g., that I go to the grocery store and pick out a tub of ice cream. When I go to the checkout aisle to pay for it, the grocery store and I each exercise certain institutional powers: the grocery store exercises its power to sell the ice cream, and I exercise my power to buy it. Through this exercise of institutional powers, we change our statuses with respect to the tub of ice cream. Prior to the purchase, the grocery store had the authority to act in certain ways toward the ice cream (e.g., moving it in and out of storage), and other people had certain obligations not to interfere with the grocery store in its interactions with the ice cream. But after the purchase, there is a change in first-order obligations: *I* now have the authority to act in certain ways toward the ice cream (e.g., eat it), and other people now have an obligation not to interfere with me in my interactions with the ice cream.[9]

[9] Strictly speaking, "buying" and "selling" should be understood as institutional operations that change not only first-order social obligations (e.g., who can do certain things to the tub of ice cream) but also the assignment of certain institutional powers (e.g., buying the ice cream gives me the institutional power to determine what constitutes permissible conduct with respect to the ice cream and gives me the institutional power to transfer these institutional powers to others through a sale or gift). Legislation typically operates at an even higher level, where legislators alter the structure of rules that determine the scope of the institutional powers of owners over the things that they own, what sorts of powers can be transferred through buying and selling, and the sorts of goods that may be the object of buying and selling.

What makes a market a part of the civil sphere, on my view, is the fact that the law typically allows citizens to make decisions about buying and selling based on considerations that are not connected with widely shared ideas about how society should be organized. When I go to the grocery store, I have a legally defined power to purchase chocolate ice cream or vanilla. The law allows me to exercise my legal powers based on considerations such as what I'm in the mood for. I am not required to make my decision based on which purchase would answer to some widely shared view about how society should be organized.

An *advanced market economy* is a more wide-ranging and sophisticated institution.[10] The shared understanding that constitutes an advanced market economy defines markets in a wide range of goods and services, and it defines more complicated structures, such as specialized forms of property (e.g., patents and copyrights), complex investments (e.g., mortgage-backed securities), the power to set up artificial market agents (e.g., publicly traded corporations), and a monetary framework (e.g., currencies, central banks, and financial institutions). There are, however, three features of an advanced market economy that are essential to the institution, as I understand it, and will be important in assessing the arrangement from the moral point of view. The three features are:

(a) a set of institutional requirements on market actors to act in a mutually disinterested fashion (e.g., not to collude in competitive circumstances);
(b) organizing principles that set out a public justifying rationale for the arrangement based on economic efficiency; and
(c) a complex bureaucratic apparatus whose officials are institutionally required to monitor market interaction, exercise institutional powers, and develop institutional rules in light of the public justifying aim of the enterprise, which is to maintain an economically efficient pattern of consumption and production in society.

I will have more to say about an advanced market economy in chapter 3. There I will argue that in a well-functioning arrangement of this kind, the various powers and forms of authority defined by the scheme structure

[10] For a rigorous statement of the defining features of an advanced market economy see the appendix.

market-oriented production activity and consumption activity to form a dynamical system. The stable equilibrium state of the system is a pattern of production activity and consumption activity that is "efficient" in the technical sense defined by economists. An advanced market economy effectively creates the conditions for an "invisible hand" process to constantly draw citizens into a pattern of production activity and consumption activity that is economically efficient.

Whether an advanced market economy answers to freedom, understood as a public value, depends substantially, I will argue, on how we should think about social coordination mechanisms that work in this way. The market coordination process does not make clear to citizens why they should take part in the patterns of activity that it draws them into, and it draws them into these patterns, even when citizens have significant reasons to favor other patterns. Freedom has an *anti-authoritarian dimension*, on my view, and social arrangements may be inconsistent with this value when they treat citizens as if their practical judgments can be bypassed to determine the course of their lives for them.

1.5. Too Social?

Before moving on, I want to consider an objection. Some readers might resist the institutional perspective because it presents a highly social view of our lives, a view that may be hard to reconcile with our conception of ourselves as individuals with personal lives that are distinct from the life of our community. Here it will help to say something about how the institutional perspective distinguishes what is personal from what is social.

Consider for a moment something that seems completely internal to your life as an individual: the thoughts that you think to yourself each day. In one way, these thoughts—e.g., "This coffee smells good!"—are completely personal and not integrated into some wider social consciousness. At the same time, however, the words and concepts that you use to formulate your thoughts—e.g., "this," "coffee," "smells," "good"—are all part of a wider linguistic practice. This practice integrates all of the members of the linguistic community together and undergirds the possibility of communication. In the case of language, we recognize that what is personal to us as individuals is not personal in virtue of being *asocial* or *presocial*; what is personal here is clearly embodied in facilities that are social and involve everyone in a community.[11] What makes your thoughts personal to you is how you use the building blocks in the wider linguistic practice to construct a distinctive set of propositional commitments for yourself.

The institutional perspective takes language as a model for the relation between what is personal and what is social in a liberal democracy. The personal aspects of our lives are not like the activities of Robinson Crusoe, collecting seashells far from the company of other human beings. The personal aspects of our lives are the actions and activities that we undertake within the medium of an institutional order that binds everyone together. What is personal to me is the particular marriage that I enter into, the particular tub of ice cream that I buy, the particular spot that I take in line for the water fountain. These relationships, statuses, and activities are personal, not because they are asocial or presocial but because they are the product of the particular ways that I make use of the powers that are available to me within the wider institutional order in my community.

It should be clear at this point that the conception of social institutions implicit in the institutional perspective is fundamentally different from the conception favored by many economists.[12] The conception of social institutions implicit in the institutional perspective is one favored instead by many political scientists, legal theorists, sociologists, and anthropologists. This view treats social institutions as part of background normative understanding that binds the members of a community together, a scheme of shared rules for how members should think and act. Members encounter these rules when they are born and are socialized into them over time. Most everyone regards the rules as presumptively legitimate, so they see themselves and everyone else as having an obligation to adhere to these arrangements.

According to the institutional perspective, an advanced market economy is a social institution, much like the family, scientific inquiry, or democratic government: it is part of the *culture* of Western liberal democracies. It forms

[11] Language itself is not a formal institution, or even an informal one: it is hard to see how basic features of language—e.g., meaning and reference—could be understood simply in terms of a shared normative understanding among the members of a linguistic community. But language does have certain features that may be understood as an informal institution or social practice.

[12] According to one widely held view among economists (and many philosophers), institutions are external rules, backed by sanctions, that constrain the behavior of rationally self-interested actors. The conception of institutions implicit in the institutional perspective rejects the idea that individual actors are or should be motivated simply by rational self-interest. It assumes instead that these actors can and should be motivated by other considerations (e.g., moral duties and obligations), and it conceives of institutional rules as guidelines for thought and conduct among actors who see themselves as having a duty or obligation to adhere to these guidelines.

part of the complex array of background institutions that defines how everyone in the community should think and act in certain contexts. The view of markets as social institutions in this sense is the dominant view in economic sociology (e.g., Smelser and Swedberg 1994; Granovetter and Swedberg 2001; see also Hall and Soskice 2001) and is substantially shared by canonical figures such as Durkheim (1984), Weber (2010), Hegel ([1821] 1991), and Marx (1967).

1.6. Public Values

Up to now, I have discussed one part of the institutional perspective, which has to with social institutions and the institutionally defined character of the public-private distinction. Let me turn now to the other part of the framework, which has to do with values.

In the first instance, values are structured complexes of normative requirements that apply to human thought and conduct (Scanlon 1998; see also Anderson 1993; Scheffler 2010c; Walzer 1983). Some values are *private values*: these requirements apply mainly to the thought and conduct of human beings, understood as disconnected individuals, leading distinct and separate lives. Among private values we might include various ideals of promise keeping, truthfulness, and personal friendship. *Public values*, by contrast, are structured complexes of normative requirements that apply to the thought and conduct of human beings understood as partners in a political community. Some important public values include democracy, social justice, and economic efficiency.

A social order is a potential scheme of rules and principles that members of a community may collectively adopt as a shared framework for practical reasoning. Public values are best understood as normative standards that apply to a social order, where satisfying the standard qualifies the abstract scheme of rules and principles in some way to play the role of a shared framework for practical reasoning in a community. For example, a conception of social justice gives us a standard for assessing an institutional order, and satisfying the standard qualifies the order in a distinctive way to serve as a framework for social life.

According to the institutional perspective, public original values are irreducible features of practical reason (Scheffler 2010a, 2010b). Public values make demands on an institutional order, but these demands cannot be understood simply in terms of values that apply to us as disconnected, private individuals. For example, social justice is a public value that makes demands on how background institutions determine the distribution of important resources, but we cannot reduce the requirements of social justice to private values, such as a private ideal of fairness that might apply to parents handing out treats for their children. This is because private ideals generally *presuppose* institutional rules that structure and define the social context in which these values operate. Any parent has, in the first instance, just those resources to hand out as treats for her children that a just scheme of ownership allots to her and her family. Without the context of framework institutions that establish the fundamental contours of social life, private ideals have little content. Because private ideals presuppose a social framework in this way, they cannot explain the content of framework-ordering public values.

In later chapters, my argument will focus on one public value in particular: *the Kantian ideal of mutual respect*. This ideal represents one of several that inform our thinking about freedom, and it has a distinctively moral character. According to the Kantian ideal, the rules and principles of an institutional order must be consistent with a particular way that members of a political community may regard themselves and one another. Members may regard themselves and one another as free persons, each with a fundamental dignity that entitles her to guide her activities in light of her own practical judgments. The institutional order in a political community must be consistent with citizens respecting themselves and one another as free persons, and when an institutional order is inconsistent with this form of respect—e.g., it treats citizens as if their practical judgments don't matter—the order suffers from a distinctive moral defect.[13] I will say more about the Kantian ideal in chapters 4 and 5.

A central feature of the institutional perspective is that public values can make demands on all aspects of a potential institutional order, *including both political institutions and civil institutions*. The basic idea that public values can make demands on all aspects of an institutional order for our society,

[13] The Kantian ideal of mutual respect appeals to a conception of how the members of a political community should regard themselves and one another. This pattern of regard is different from a pattern of regard that may be important even among individuals who are not members of the same political community. For example, Scanlon (1998) argues that we can understand the requirements of morality in general in terms of a way of people relating to each other in which it is possible for them to justify their actions to each other on reasonable terms. Although I refer to the Kantian ideal as the "Kantian" ideal, I want to emphasize that the sources of the ideal are more varied; see especially Rousseau (2018); Kant ([1785] 1996); Marx 1967; Habermas 1996; Scanlon 2003b; J. Cohen 1989.

in both the political and civil domains, is, I think, quite ordinary and widely accepted in our political culture. But it is generally less prominent in philosophical discussions of economic life, so it is worth taking the time to make the idea more concrete and familiar. Let me offer now some commonsense examples of how civil institutions in liberal democracies as we know them (a) are designed in ways that are sensitive to public values, (b) are widely recognized as being designed in ways that are sensitive to public values, and (c) are qualified to serve as shared frameworks for practical reasoning in a community in part because they answer to public values.

1.6.1. Marriage

In liberal democracies as we know them, marriage is a civil institution that provides people with the power to enter into marriage relationships as private individuals. When citizens exercise the power to enter into marriage relationships, they need not take public values into consideration—they are free to make decisions based on private concerns like love, sex, and compatibility. That being said, public values nevertheless play an important role in determining the correct forms of power and authority defined by marriage as a civil institution. For example, the health and safety of children is an important public value, and this value factors in several ways into the rules of marriage and divorce. In many jurisdictions, the rules regarding the division of property in a divorce assign greater resources to the spouse with primary custody of children as a way of securing the material interests of the children involved. In this case, the married partners themselves may be free to make decisions about marriage and divorce based on considerations such as sex, love, and compatibility. Nonetheless, the structure of marriage as a civil institution answers to a public value—i.e., the health and safety of children—in the way that it organizes the division of property at dissolution.

1.6.2. School Choice

Many education theorists believe that a liberal democracy should give parents a choice about where their children go to school (Mill 1906; see also Brighouse 2003). Some even think that for-profit enterprises should be allowed to marshal resources in the open market to sell educational services to parents (Friedman [1962] 1982; Hayek 1960).[14] But even among theorists who favor market coordination, there is widespread recognition that civil institutions must carefully structure the legal powers of parents and of for-profit educational enterprises in light of certain public values.

Milton Friedman ([1962] 1982), e.g., famously argues for a voucher system to organize primary and secondary education. Friedman's scheme would give parents the legal power to decide where their children will go to school, and it would give firms the legal power to sell education services to parents for a profit. But Friedman recognizes that a stable democratic society is an important value, and that this kind of arrangement would be "impossible without a minimum degree of literacy and knowledge on the part of most citizens and without widespread acceptance of some common set of values" (89).

In recognition of the importance of a stable democratic society, Friedman's voucher scheme structures and limits the legal powers of the various players involved. The system does not give parents and firms the freedom to choose just any curriculum for children, such as a fundamentalist religious curriculum that would cultivate illiteracy or hostility to democratic ideals. It is the government's responsibility, under Friedman's ([1962] 1982, 89) scheme, to ensure that "the schools [meet] certain minimum standards, such as the inclusion of a minimum common content in their programs." The scheme effectively structures and defines the legal powers of private actors in recognition of an important public value. In the debate about school choice, most everyone recognizes that civil institutions must answer to public values, even classical liberals who favor a structure that creates significant legal powers for parents and firms.

1.6.3. Private Property

Private property is another civil institution whose structure answers to public values. In the United States, the Constitution protects the freedom of expression, and it does so particularly insofar as this freedom is an essential foundation for political discussion and democratic accountability (see *New York Times Company v. Sullivan*, 376 U.S. 254, 1964). The legal powers of

[14] Not everyone accepts these claims, and some would argue that we could not achieve important goals such as racial integration if we give parents exclusive authority over where their children go to school (Gutmann 1987).

private ownership have a structure that answers to this constitutional ideal. For instance, in *PruneYard Shopping Center v. Robins* (447 U.S. 74, 1980), the US Supreme Court upheld a decision by the Supreme Court of California, according to which citizens in California have a right to speak and petition, even when their speech activity occurs within a privately owned shopping mall. The system of private ownership in California defines the legal powers of mall owners in such a way that owners can impose reasonable time, manner, and place restrictions on speakers, but they cannot exclude speakers from their malls altogether. Here the property rights system adjusts the legal rights of private ownership in recognition of public values, such as freedom of expression and democratic accountability.

Another important public value is intellectual advancement and the accumulation of knowledge. The systems of property in liberal democracies create powers of ownership in abstract objects, such as technological innovations and works of art (see Hettinger 1989). These powers of intellectual property exist, in part, to create financial incentives for people to use their creative abilities in socially useful ways. But the structure of these powers also reflects an important interest in preserving the free flow of ideas that is essential for intellectual progress over the long run. For example, copyright protection in most countries limits the legal power of copyright holders by allowing for the "fair use" of copyrighted materials without the owner's consent. These provisions ensure *inter alia* that people can properly discuss and assess scientific, historical, and sociological claims by citing the relevant source materials, disseminating evidence, and responding to arguments. Similarly, patent protections typically require the patent holder to outline the nature of her invention and to make the outline public, thereby allowing other inventors to understand the idea and to build on it. Intellectual property, as we know it, is much more than Lockean acquisition and exchange; it is a civil institution whose rules create a system of rights, duties, and powers that answers to a range of public values, including those of intellectual progress and rational belief formation.

1.6.4. Business Corporations

In most liberal democracies today, the law provides people with the legal power to create a business corporation. I will have more to say about this civil institution in chapter 7. For the moment, we can think of the business corporation as an organization that is recognized in the law as an independent legal person. Among other things, a business corporation can own property, enter into contractual relations, exercise authority over employees, and be held responsible for civil damages (see Orts 2015).

The corporate law in most liberal democracies establishes a certain default pattern for the internal structure of a business corporation. In the United States, Canada, and the United Kingdom, this default pattern puts executive officers in control of the day-to-day operations of the firm and makes these officers answerable to shareholders indirectly through a board of directors. This institutional structure has wide-ranging social implications; e.g., it effectively creates a powerful class of managers whose preferences can, under the right conditions, shape the distribution of income in society. It also gives the interests of shareholders a certain privileged position, as it makes corporate managers answerable to shareholders in a way that they are not answerable to other parties, such as workers or suppliers.

Why does the corporate law define the legal powers of incorporation in ways that favor the formation of shareholder-controlled firms? The dominant view among legal theorists and economists is that the corporate law favors these types of firms because doing so answers to an important public value, namely economic efficiency:

> As a normative matter, the overall objective of corporate law—as any branch of law—is presumably to serve the interests of society as a whole. More particularly, the appropriate goal of corporate law is to advance the aggregate welfare of all who are affected by a firm's activities, including the firm's shareholders, employees, suppliers, and customers, as well as third parties such as local communities and beneficiaries of the natural environment. This is what economists would characterize as the pursuit of overall social efficiency. (Armour, Kraakman, and Hansmann 2009, 28)

How does shareholder control answer to the demands of efficiency? Think of it this way (see Jensen 2001, 2002; Hussain 2012a). If consumers are willing to pay price P for some product X, and P more than covers the cost of producing X, then this opens up an important possibility. It is possible for a producer to make X and to sell it to consumers at price P, which would then leave consumers better off (i.e., consumers get a product that is worth more to them than what they give up) and leave producers better off as well (i.e., the producer makes a profit). Assuming that no one else is affected, social welfare would increase through exchanges of this kind. Now if firms in the economy are oriented toward pursuing profits, they are looking to make products that command a price in the market that more than covers the costs of production, which means that they are looking for exchange opportunities that will, in effect, improve the lives of consumers and increase aggregate welfare. According to this argument, among the various stakeholders in the firm, shareholders are the most likely to keep the corporation focused on making profits, so by putting shareholders in control, the law effectively aims to ensure that corporations will operate in ways that will lead to a higher level of aggregate welfare in the long run (see, e.g., Easterbrook and Fischel 1991).

The important point, for my purposes, is that the mainstream debate about corporate governance takes for granted that the corporate law is a civil institution that answers to public values. Eventually, I will argue that the mainstream view is misleading because the corporate law must answer to other values besides economic efficiency. But in terms of the institutional perspective, most everyone agrees that the corporate law is a civil institution that defines legal rights, duties, and powers in ways that answer to public values.

1.7. Summing Up

According to the institutional perspective, the central questions of political philosophy are questions about the proper structure for the complete institutional order in a political community. The order must answer to an array of public values, which determine the proper structure for institutions in both the political sphere and the civil sphere. Civil institutions, such as marriage, school choice, private property, and business corporations are all part of the "private" domain in that citizens can generally exercise the forms of power and authority they define as private individuals. But the structure of these forms of powers and authority must answer to public values, such as a stable democratic society and the welfare of children.

The institutional perspective forms the backdrop for the discussion in the rest of this book. An advanced market economy is the characteristic institutional arrangement that provides a shared framework for practical reasoning in economic life in liberal democracies today. The arrangement has features that span both the political and civil spheres. My goal is to assess this arrangement in terms of public values, focusing in particular on values related to human freedom. In the next chapter, I will use the institutional perspective to situate the questions that are my main concern in relation to the liberal ideal of a sphere of freedom for private individuals.

2
Liberal Freedom Is Not the Issue

I began the previous chapter by noting that many theorists today treat economic life simply as an arena in which individuals with private property interact with other individuals with private property. The institutional character of the powers of private ownership and exchange are seldom properly acknowledged or properly theorized. This leads to a situation in which people tend to associate (a) the liberal ideal of a domain of freedom for private individuals with (b) the full range of institutional powers commonly associated with private property in a market economy. This intuitive association makes it difficult to address certain normative questions about the market clearly.

In this chapter, I want to look more carefully at the liberal ideal and show that it is not as closely tied to the powers of private ownership and exchange as people sometimes assume. According to the *indifference thesis*, the liberal ideal of a domain of freedom for private individuals can be realized in social orders with widely varying economic arrangements, so the liberal ideal does not directly determine the choice between these arrangements—the liberal ideal is "indifferent" between these institutional forms. Once we see that the basic liberal concern for the freedom of citizens as private individuals is not what is at issue, we can consider more clearly how various economic arrangements answer to other moral concerns.

2.1. Freedom for Private Individuals

In chapter 1, I drew a conceptual distinction between the public and the private. The public corresponds to the political sphere: in these institutional settings, citizens are required to exercise institutional powers on the basis of considerations that stem from widely shared ideas about how society should be organized. The private corresponds to the civil sphere: in these institutional settings, citizens are permitted to exercise institutional powers on the basis of considerations that stem from their own personal goals, plans, and

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projects. This distinction between the public and the private is merely conceptual, and it is a further question what forms of power and authority (if any) belong in the political sphere and what forms (if any) belong in the civil sphere.

In the history of liberal democratic thought, a centrally important ideal bears on the assignment of powers to the two spheres. This ideal says that a properly ordered system of social institutions must place certain forms of power and authority in the civil sphere. These forms of power and authority define a domain in which citizens can think, act, and associate with one another freely as private individuals. There are many ways of articulating and defending this ideal (among others, see Hegel [1821] 1991; Mill 1906; Scanlon 1988; Dworkin 1977; Habermas 1996). I will base my view on Rawls's (1993a) account because it is the most fully developed for my purposes.[1] But many other formulations would also endorse some version of the indifference thesis.

On Rawls's (1993a, 291–2) view, the *basic liberties* are a list of fundamental civil and political freedoms that have played a central role in the liberal democratic tradition. Among these liberties are:

- the freedom of thought and liberty of conscience;
- the freedom of association;
- the freedoms specified by the liberty and integrity of the person, including the rights of personal property, freedom of movement, and free choice of occupation;
- the rights and liberties covered by the rule of law;
- the political liberties, including the right to vote and run for office; and
- the freedom of political speech, freedom of the press, and the freedom of assembly for political purposes.

The list of basic liberties includes both civil and political freedoms. This is because the liberal democratic tradition is concerned both with the freedom of citizens as private individuals as well as the freedom of citizens to exercise political power in society as equals. For my purposes here, I will focus

[1] I take it that Mill's (1906, 1994) view is more or less the same as Rawls's, at least in terms of the substantive demands that it makes on social institutions (see Rawls 2007, 267). Rawls and Mill both emphasize the importance of each individual's interest in shaping her life in light of her own practical judgments. Where they differ is in the moral justification for these institutional requirements: Rawls appeals to a form of contractualism, while Mill appeals to a form of utilitarianism.

only on the civil freedoms on Rawls's list. These basic civil liberties define a domain in which citizens can form various beliefs as private individuals, express and discuss their beliefs, associate with one another in light of these beliefs, and organize their lives in light of their convictions.

With respect to each of the basic civil freedoms, an institutional order provides citizens with the liberty when it provides them with a certain set of "protected pathways and opportunities." The rules of the order must be structured so that citizens have the legal authority to engage or not to engage in certain activities on the basis of their own judgments, and the rules must be structured so that others are legally required not to interfere with citizens in taking part in these activities. For instance, if

> we consider liberty of conscience as defined by law, then individuals have this basic liberty when they are free to pursue their moral, philosophical, or religious interests without legal restrictions requiring them to engage or not to engage in any particular form of religious or other practice, and when other [people] have a legal duty not to interfere. (Rawls 1999, 177)

Each of the basic liberties has a "central range of application." This central range refers to the specific institutional powers and forms of authority that are essential to a citizen's enjoying the liberty. If the institutional order does not provide citizens with powers and authorities that cover the activities in this central range, then it does not provide them with the basic liberty in question. For instance, the liberty of conscience necessarily involves the authority of individuals to form their own beliefs about morality and value, and a social order would not provide citizens with this liberty if it incorporated a legal requirement to endorse a certain set of religious beliefs.

On Rawls's view, there is a difference between a citizen's having a certain liberty and a citizen's being able to take advantage of it. An institutional order may provide citizens with a certain basic liberty insofar as it provides them with the relevant legal powers and forms of authority. Yet it may be the case that many citizens lack the material resources or the knowledge to take advantage of these opportunities (Rawls 1993a, 324–31; Daniels 1975). Citizens in a liberal democratic social order may have religious liberty because they have the legal authority to live their lives as devout Catholics, Muslims, Jews, or what have you. This means that citizens have the legal authority to form the relevant beliefs and commitments, as well as the authority to organize their lives in light of these beliefs and commitments. Nonetheless, many citizens may lack the material resources necessary to live consistently with the normative beliefs and commitments that they form—e.g., they may lack the material resources to spend their life studying religious texts, going on pilgrimages, or building temples.[2]

Outside of the central range of application, the basic liberties raise important questions of regulation and balancing. Questions of regulation follow from the fact that certain institutional rules may be necessary in order to ensure that a liberty actually serves its underlying purpose; e.g., rules governing who can speak in a public park may be necessary to ensure some orderly discussion of social and political issues. Questions of balancing arise from the fact that the requirements of one basic liberty may come into conflict with those of another; e.g., gag orders and other restrictions on the freedom of speech and freedom of the press may be essential to ensure the right to a fair trial.

In order to settle various questions about regulation and balancing, the basic liberties must be connected with some deeper account of the role that they are supposed to play in a liberal democracy. Rawls introduces the idea of "full adequacy" to address these issues. Citizens in a liberal democratic social order are understood to have the potential to develop and to exercise two fundamental moral powers: (a) the capacity for a sense of justice and (b) the capacity for a conception of the good. A scheme of basic liberties is fully adequate when they "guarantee equally for all citizens the social conditions essential for the adequate development and the full and informed exercise of [the two moral powers] in . . . 'the two fundamental cases'" (Rawls 1993a, 332).

I will focus on the second of the two fundamental cases, since this is the most relevant for my purposes. The basic idea is that, under the right conditions, citizens have the potential to develop and fully exercise a capacity to rationally form, revise, and pursue a conception of a worthwhile human life (Rawls 1993a, 302). Among other things, citizens will form a determinate *practical identity*: they will have a set of goals, attachments, loyalties, and

[2] I take it that the basic liberal distinction between having a liberty and being able to take advantage of it is meaningful and normatively significant (cf. Daniels 1975). There is an obvious moral difference between, say, an apartheid regime that denies members of a certain ethnic group core elements of the freedom of movement and a liberal democratic regime in which certain ethnic groups lack the material resources to move from one part of the country to another. No doubt, both societies are open to criticism, but it would be oversimplifying things to say that economic deprivation always constitutes a deprivation of basic freedoms. The apartheid regime goes much further in denying people the fundamental status of a citizen who may rightfully claim to move around the country as she sees fit.

final ends, along with a deeper moral, religious, or philosophical outlook that makes sense of these commitments. Citizens will rationally revise their goals and attachments to fit better with their final ends, and they will revise their final ends in light of new experiences. Citizens also have the power to relate to their practical identity as something that is not simply given to them by tradition but is a reasoned expression of their own judgments.

A scheme of basic liberties is fully adequate, in part, when it secures the social conditions necessary for citizens to realize the capacity for a conception of the good. Take the liberty of conscience to illustrate (Rawls 1993a, 310–5). A social order provides people with the liberty of conscience when it provides them with the legal authority to form their own beliefs and commitments, to live consistently with these beliefs and commitments, and to demand that others not interfere with them in these activities.

The liberty of conscience supports the capacity for a conception of the good in three ways. (1) Given that a citizen has a certain practical identity, the liberty of conscience will protect her basic ability to orient her activities in light of this identity, whatever it turns out to be—i.e., it will provide her with the legal freedom to live consistently with the principles of Christianity, Judaism, or what have you. (2) The liberty of conscience will prevent the law from simply mandating that people hold certain beliefs and commitments, which protects the conditions in which citizens have the opportunity to change their views and potentially to make mistakes. These opportunities are essential for citizens to develop the capacity to revise their practical identities in a rational way. (3) Finally, by protecting the conditions in which citizens can interact with different traditions and subcultures, the liberty of conscience allows citizens to explore other outlooks and to relate to their own tradition, not simply as something that they do but as a set of commitments that they embrace on the basis of certain underlying reasons.

Full adequacy is an important notion in part because it implies that there is no such thing as a "maximally expansive" scheme of basic liberties or sphere of freedom for private individuals (Rawls 1993a, 332–3). Each of the basic liberties may come into conflict with other basic liberties: one person's freedom to speak on any occasion may interfere with other people's freedom to have exclusive conversations. As such, there is no simple sense in which we can rank order different schemes of basic liberties in terms of, say, the number of actions that they bring under the scope of our control as private individuals (cf. Carter 1999).[3]

2.1.1. A Zone of Noninterference?

I want to draw attention now to an important point about how to understand the basic liberties in the context of a modern liberal democratic society. Recall from chapter 1 that the civil sphere is not a domain for the unrestrained pursuit of self-interest within the boundaries of private property. On any realistic conception, *the civil sphere is an institutionally defined arena for social interaction*. The civil sphere consists of a wide array of social institutions that provide people with various institutional powers and forms of authority that they may exercise as private individuals. Against the background of this conception of the civil sphere, it is a mistake to think of the basic liberties as defining a "zone of noninterference" roughly analogous to the zone of noninterference that you might enjoy on a desert island if no one touches you or crosses your path. The basic liberties are best understood instead as *complexes of institutional powers* that citizens may exercise as private individuals.

Consider the case of marriage. A fully adequate scheme of basic liberties must provide citizens with the institutional authority to decide as private individuals whether to enter into a marriage and with whom. Any social order that centrally plans marriages or requires citizens to enter into marriages for reasons stemming exclusively from *public values* would fail to provide citizens with a fully adequate scheme of basic liberties.[4] What I want to stress, however, is that marriage is clearly a legal institution, backed by coercive force, one that involves a complex set of legal relations involving property, custody, inheritance, taxation, etc. What the liberal ideal requires, on the Rawlsian view, is that citizens have the authority to make decisions

[3] Furthermore, when we look at different schemes of basic liberties in terms of the underlying purpose they serve, there is no clear sense in which this purpose has some maximization point. As Rawls (1993a, 333) notes, "we have no notion of a maximum development of [the two moral powers]." What would it mean for citizens to be maximally able to see their practical identity as a form of reasoned self-expression? Or for them to be "maximally" in possession of a determinate practical identity?

[4] The most obvious failures would involve liberty of conscience, freedom of association, and the freedoms associated with integrity of the person, which I assume would protect an individual's authority over her sexual partners. For an example of a regime of this kind, see Plato's scheme for marital relations among the guardians in *The Republic*.

about marriage as private individuals. But the normative requirement in this case is completely different from the libertarian idea that freedom consists in a person's having a "zone of noninterference" that is analogous to the zone of noninterference that Robinson Crusoe might have on his desert island.

The picture that emerges from the foregoing is one in which the basic liberties are a set of abstract freedoms that are realized in a complex substrate of specific institutional powers and forms of authority. The institutional power to enter into a marriage of your own choosing is one example of an institutional power that may form part of the substrate in which the basic liberties are realized. But many other institutional powers and forms of authority may be part of this substrate as well, including the power to choose what university to attend, what books to take out of the library, and what internet searches to run. The powers that will figure most prominently in my discussion are various institutional powers in the economic realm, such as the power to buy and sell goods and the power to offer and accept employment. Some of these institutional powers in the economic domain will be essential to a fully adequate scheme of basic liberties; others will not. Let me say more about this with respect to property.

2.2. Personal Property

On Rawls's view, no social order could provide citizens with a fully adequate scheme of basic liberties without providing them with a range of powers that allow them to exercise certain forms of control over physical objects and the physical environment. Call these the powers of *personal property* (Rawls 1993a, 298, 338–9; Radin 1993; see also Mill 1994, 326–8).

Think here of the institutional powers that allow citizens to have a private dwelling of some kind. It would be virtually impossible for a person to develop her own practical identity without some place where she could think clearly for herself as an individual, apart from other individuals, and pursue relations with other people of her own choosing. So in order for a scheme of basic liberties to be fully adequate, it must incorporate institutional powers that would allow individuals to exercise exclusive control over a dwelling or abode. These powers would allow individuals to control the relevant space for a certain period of time and would allow them to exclude others from having access to the space.[5]

[5] The institutional powers that create the general opportunity for people to have personal property are different from the institutional powers that give specific individuals control over some specific

What is important for my purposes is that the institutional powers that constitute the power to own personal property are much narrower than the full range of institutional powers associated with private ownership and exchange in a market economy. To appreciate the difference, ask yourself: What types of objects do people need to be able to control in order to develop and exercise the capacity for a conception of the good?

To have a secure institutional environment for developing this capacity, individuals must be able to exercise private control over a place to live—i.e., a dwelling. In addition, they need to be able to exercise private control over various effects, such as computers, smartphones, clothing, books, and food. On the other hand, a social order could provide people with a secure environment for rationally formulating and revising a practical identity without also providing them with the possibility of exercising private control over offshore natural gas deposits, shopping malls, or fleets of shipping containers. The scope of private control that is necessary for people to be able to rationally form and revise a practical identity is much narrower and more closely connected with the person than the full range of powers associated with private ownership and exchange in a market economy.

Consider a second question. Suppose that we have a list of the types of objects that people normally need to be able to control in order for them to develop a practical identity. What forms of control do people need to be able to exercise over these objects in order to develop and exercise the relevant capacities?

Many forms of control may be required, depending on the object that is at issue. But in general, people must be able to access the object, and they must be able to exclude others from having access to it for certain periods of time. For example, when it comes to a dwelling, people need to have the power to access the space and exclude others from using the space based on considerations such as personal preference. In addition, people may also need to have certain powers to physically alter the relevant objects, either by consuming them or by working on them—people need to be able to make a dwelling reflect their own values, to make computer files express their own ideas, etc.

set of objects at some particular point in time. What is essential to a fully adequate scheme of basic liberties is that people must have the opportunity to exercise private control over an adequate realm of personal effects. But incorporating a set of powers that creates this institutional opportunity is different from incorporating the institutional powers that would constitute some particular person's having control over an adequate set of objects at some particular point in time.

But here again the powers of personal property are much more limited than the full range of institutional powers associated with private ownership and exchange in a market economy. When it comes to a dwelling, e.g., a social order could provide people with a fully adequate scheme of basic liberties by providing them with the power to exercise exclusive access to and control over a house. But satisfying the demands of the liberal ideal would not also require that the order provide people with the power to buy and sell homes for a profit, the power to demolish houses to make way for shopping malls, or the power to amass a real estate empire without limits. An institutional environment can provide people with a scheme of basic liberties that is fully adequate without also providing them with the far more extensive powers that make up a private property economy based on markets and exchange.

2.2.1. An Illustration: The University

A helpful way to think about the requirements of the liberal ideal is to think about the case of a university. Most universities in North America are designed to provide students and faculty with a sphere of freedom as private individuals. Various rights of free speech and association create an institutional setting in which students and faculty can discuss ideas, access relevant information, form their own opinions, and associate with one another in light of their distinct practical identities.

As part of the institutional setting for a sphere of freedom for private individuals, universities provide members with certain forms of control over their physical environment. Students and faculty have institutionally defined powers to access and exercise temporary exclusive control over things like dorm rooms, offices, classrooms, basketball courts, computers, and books. These powers give students and faculty spaces in which they can think for themselves, places where they can discuss ideas, and material resources to organize their lives consistently with these ideas.

Importantly, however, universities typically do not provide members with the full range of powers associated with private ownership and exchange in a market economy. On the one hand, the forms of property that the university provides to members involve a more limited range of objects. Students have control over things such as dorm rooms, classrooms, and computers, but they do not have control over heating and cooling systems, university servers, administration buildings, etc.

On the other hand, the forms of property that the university provides to members involve more limited forms of control. Students have exclusive access to their dorm rooms for a certain period of time (e.g., an academic year) and the authority to organize their dorms as they please (within reason). But students typically do not have the right to sublet their rooms, the power to buy and sell their rooms, or the power to band together and collectively demolish a dormitory to build an office tower or to farm the land below. Similar restrictions apply to faculty members and their offices.

The university is a helpful illustration because in many ways it represents the *fullest realization* of the liberal ideal of a sphere of freedom for private individuals. The institutional structure of the university is precisely aimed at creating an environment in which people can each rationally form, revise, and pursue a practical identity, in a context with many different traditions and points of view. Yet the university setting is one in which members have powers of private ownership that are limited in important ways; e.g., dorm rooms are owned and controlled by the university community as a whole, and so are offices, classrooms, basketball courts, heating and cooling systems, computer servers, land, etc. In some ways, the structure of institutional powers in a university actually parallels the structure of a liberal democratic socialist regime. My point is not that we should reorganize society along the lines of a university, but simply that the university serves as a particularly clear illustration of how an institutional structure can provide people with a fully adequate sphere of freedom for private individuals, without also incorporating the full range of powers associated with private ownership and exchange in a market economy.

2.3. Two Justifying Rationales for Institutional Powers in the Economic Realm

At this point, I want to introduce a distinction between two ways of looking at institutional powers in the economic domain. There are at least two different basic rationales that can serve as a justification for a social order to provide people with certain economic powers.[6]

[6] I focus on two rationales here. I discuss some other rationales for economic powers in Hussain (2012b). Private control over charitable giving, e.g., may be justified as part of a decentralized mechanism for the delivery of social services (see Hussain 2012b, 139; Reich 2011; see also Mill 1994, chapter 11).

One justifying rationale is that the institutional powers in question are *constitutive of a fully adequate scheme of basic liberties*. In order to illustrate this rationale, consider the institutional power to purchase goods in the market. For the most part, citizens in market societies today live under a very advanced division of labor, and they are typically not in a position to make most of the things on their own that they consume. As such, citizens exercise control over many aspects of their lives mainly through their decisions about what kinds of goods and services to buy in the market. Given that they exercise control over their lives in this way, certain institutional powers to make buying decisions based on their own conceptions of the good are constitutive of an adequate liberty of conscience.

To illustrate, let's assume that the central range of application for the liberty of conscience includes activities such as reading certain books and eating certain types of food. To have the liberty of conscience, then, people must have institutional powers that allow them to engage or not to engage in reading certain books (e.g., religious texts) or to engage or not to engage in eating certain foods (e.g., meat or bacon). In a market society with an advanced division of labor, citizens exert control over these aspects of their lives through their purchasing decisions. It follows that a fully adequate scheme of basic liberties would also include certain forms of authority with respect to these decisions. Among other things, to have an adequate liberty of conscience, citizens in contemporary market societies must have the institutional power to decide what sorts of books they will buy and whether or not they will buy meat or bacon at the grocery store.

Importantly, however, the basic liberties rationale for market powers does not extend very far: most institutional powers associated with a modern market economy are not essential to an adequate liberty of conscience or an adequate scheme of basic liberties more generally. For example, the power to purchase shares in a publicly traded corporation is an institutionally defined power in a modern market economy. As part of their ownership rights, shareholders in a company such as Walmart have the power to shape company policies. Now shareholders may want to use these powers in ways that ensure, e.g., that Walmart will hire only Christian workers and thereby maintain a Christian workplace. But the powers connected with owning a share in a company are quite different from the power to purchase goods for your own consumption that I mentioned above. The powers of share ownership are not an avenue through which we shape some aspect of our *own* lives, an aspect that falls within the central range of application for the liberty of conscience. One could make a similar point about the powers of owners in a closely held business enterprise (see *Hobby Lobby v. Burwell*; see also Hussain and Sandberg 2017). These other powers, though they involve ownership and exchange, are not constitutive of an adequate liberty of conscience.

In a modern liberal democracy only a limited subset of economic powers are actually constitutive of an adequate scheme of basic liberties. For the most part, the institutional powers and forms of authority that citizens exercise in the economic sphere have a justification that is independent of basic liberal freedoms.

A different justifying rationale for institutional powers in the economic realm is that these powers are *constitutive of an attractive mechanism of social coordination*. The institutional power to buy and sell goods, e.g., is an important power that people have in a market society. This power plays an important role in a wider economic system that continuously draws people into certain types of production activity and certain types of consumption activity. Although some of the institutional powers that market institutions provide to people in a modern liberal democracy will have a justification that is tied to the role that these powers play in realizing a fully adequate scheme of basic liberties, most of these powers—e.g., buying and selling natural gas deposits, setting up business corporations, issuing stocks and bonds, declaring bankruptcy—are not tied to this rationale. The institutional powers that make up a modern market economy are mostly justified in light of the fact that they form a particular mechanism of social coordination, one that we have reason to want because it answers to a variety of important public values.

2.3.1. Back to the University

The distinction between the two justifying rationales for institutional powers in the economic domain is an important one, and I want to make the distinction more vivid by returning to the case of the university. Suppose that a university provides students with the institutional powers necessary for exercising private control over a dorm room and thereby provides students with one part of an institutional environment that secures the social conditions necessary for them to develop and exercise the capacity for a conception of the good. Suppose that the university also provides students with the other institutional powers that make up an adequate environment. Once it has provided students with these powers, the university faces a different kind of question.

Under conditions of freedom, students will each form their own distinct practical identities, and they will each find that a distinct set of resources would help them to realize their final ends. For example, some students will want rooms closer to the physics lab because they want to be physicists, while others will want rooms far away from people so that they can practice the drums. Once the university provides people with the basic institutional pathways and opportunities necessary for private individuality, it must now consider different ways to produce and distribute the means for students to realize their practical identities.

For the sake of simplicity, let's hold off on the production side of the issue and focus on distribution. Suppose that the university already has a set of dorm buildings on campus. How might the university distribute control over these rooms to students? One way would be to start with some more or less arbitrary assignment of authority over rooms, and then give students the institutional power to exchange rooms with one another. Establishing a system of exchange would allow students to identify rooms that are more suited to their aspirations, and then seek out a series of trades that would give them control over one of these rooms. Over time, a room exchange might improve the assignment of rooms in the university, putting each person in control of a room more suited to her aspirations.

A room exchange is one way to distribute authority over rooms in the university, *but there are many others*. The university could adopt a system in which students submit their room preferences to a central office each semester, and the office could use a computer-based matching algorithm to generate the optimal assignment of rooms from the standpoint of individual preference satisfaction. Other possibilities include using more localized room exchanges or assigning dorm buildings to groups of students and then allowing each group some flexibility to democratically make decisions about how to shift walls and subdivide the building.

The important point is that when the university provides students with the power to exchange dorm rooms, this power should not be confused with the basic power to exercise private control over a room. What the liberal ideal requires in a university setting is that students should have an adequate institutional power to control some private space so that they can think for themselves, associate with people of their own choosing, etc. But a university could provide students with these institutional powers without also providing them with the institutional power to exchange dorm rooms with one another. The liberal ideal of a sphere of freedom for private individuals is compatible with many different mechanisms for distributing resources to students in light of their practical identities; some possibilities include a computer-based matching system, more localized exchanges, or democratic self-organization.

Let's bring the production side of the issue back into the picture. Once the university provides members with the basic institutional powers and forms of authority that are necessary for people rationally to form, revise, and pursue a practical identity, it faces a different challenge. Taking both production and consumption into account, the challenge is to draw members of the university community into a pattern of production activity (e.g., building dorm rooms, teaching classes, providing services) and a pattern of consumption activity (e.g., using dorm rooms, taking classes, making use of services) that exhibits certain attractive properties. The university again has many different options: it could use a complex system of exchange to draw people into the right patterns of production and consumption (e.g., an internal market), but it could also use some form of direct bureaucratic planning. If the university does decide to use a complex mechanism of exchange, it is important to see that the case for this system would not be based fundamentally on the liberal ideal of a sphere of freedom for private individuals. The case would be based instead on other values and normative ideals, such as efficiency and fairness, which bear on the choice of a social coordination mechanism in economic life.

2.4. The Indifference Thesis

We are now in a position to state the indifference thesis. The liberal ideal of a sphere of freedom for private individuals is an important and fundamental ideal in political morality. People often think that this ideal plays an important role in determining the structure of economic life. But my argument up to this point shows that, in fact, it does not play such an important role.

Following Rawls, I take it that the liberal ideal requires that a social order must provide citizens with a fully adequate scheme of basic liberties. Some institutional powers in economic life will be essential to a fully adequate scheme, including the various powers of personal property and a certain authority over purchasing decisions. But these powers are much narrower in scope than the full range of institutional powers associated with private property and exchange in a market economy. The case of the university illustrates how an institutional order could provide people with the powers of personal property, without also providing them with the more extensive powers involved in a market system—exchange, limitless accumulation, etc. In fact, as my discussion in the previous section showed, an institutional order could provide people with a fully adequate scheme of basic liberties while adopting a variety of institutional arrangements for the purposes of coordinating production and consumption activity. Once you appreciate the distinction between the two different rationales for justifying institutional powers in economic life, it is easier to see how the liberal ideal does not directly determine the structure of economic institutions in a liberal democracy.

The indifference thesis articulates the limited nature of the discriminating power of the liberal ideal.

> **Indifference Thesis.** The liberal ideal of a sphere of freedom for private individuals requires that a social order provide people with a fully adequate scheme of basic liberties. Given that a social order could provide people with a fully adequate scheme of basic liberties, while incorporating many different types of economic institutions, it follows that the liberal ideal does not directly determine the economic system that a society should adopt.

There are, of course, some economic arrangements that are incompatible with the liberal ideal. For instance, pharaonic control over land and labor, along the lines that prevailed in ancient Egypt, would be incompatible, as would certain types of command economies. But a wide array of different arrangements would be compatible with the ideal. Among these we may include various private property–based market arrangements, collective property–based market arrangements, and democratically self-organizing forms of corporatism and anarcho-syndicalism. We can also include a variety of market-based arrangements that set out different rules for the internal structure and decision-making norms of business corporations. All of these arrangements could, in principle, provide people with the powers of personal property, along with the other powers that are essential to a fully adequate scheme of basic liberties. Social orders that incorporate these various arrangements would differ, not in terms of providing people with liberal freedoms but in terms of the institutional processes that they adopt for the purposes of social coordination, i.e., for drawing members into certain patterns of production activity and certain patterns of consumption activity.

2.5. An Indirect Relationship?

Some readers might agree that the liberal ideal of a sphere of freedom for private individuals does not directly settle the question about what sort of economic arrangement a society should adopt. Nonetheless, they might argue that the liberal ideal settles the question indirectly because certain economic arrangements are distinctively supportive of liberal freedom.

Milton Friedman ([1962] 1982) offers a well-known argument along these lines. Friedman argues that bureaucratic socialism would concentrate power in the hands of public officials in a way that would threaten civil freedom. An economy with extensive powers of private ownership and exchange, by contrast, would disperse power in a way that would make the basic liberties more secure over time. As he puts it:

> The fundamental threat to freedom is the power to coerce, be it in the hands of a monarch, a dictator, an oligarchy, or a momentary majority. The preservation of freedom requires the elimination of such concentration of power to the fullest possible extent and the dispersal and distribution of whatever power cannot be limited—a system of checks and balances. By removing the organization of economic activity from the control of political authority the market eliminates this source of coercive power. *It enables economic strength to be a check to political power rather than a reinforcement.* (15; my emphasis)

Friedman is surely right that dispersing power in a society is or can be an important part of a wider strategy for making civil liberties more secure over time. But the question is whether an economic system based on private property and exchange serves this objective. Would an arrangement along these lines disperse power in ways that reinforce and strengthen the basic liberties that liberals value?

There are many reasons to be skeptical. One reason is that the distribution of economic power in a private property economy may influence the distribution of political power as well. Large accumulations of private economic power may enable small groups of individuals (or institutional actors) to threaten the civil liberties of other citizens by exercising an influence both in the market and in the political process. For example, large corporations with shared economic interests in the production of fossil fuels may coordinate their activities in the civil sphere to harass and suppress climate scientists, while also using their economic power to influence political officials to do the same things (see Coll 2013).

Friedman's reasoning also suffers from a certain inconsistency. He may be right that political officials in a publicly managed economy cannot be trusted to respect the proper limits of their authority over the economy and may use these powers to quash potential sources of dissent. But how exactly would private property help? Think here of the long history of segregation in the United States, where political officials regularly violated or ignored the legal property rights of African Americans in order to preserve the racial composition of certain neighborhoods. Or consider the situation of Arabs in East Jerusalem, who have had private ownership rights in their houses for generations, only to be dispossessed by officials in favor of other groups in Israel. If political authorities are inclined to ignore constitutional restraints on their authority in a socialist society, they may be just as inclined to do so in a society with extensive private ownership. Given lawlessness on the part of public officials, it is hard to see how private property rights are going to do anything to disperse power more widely. As African Americans living under segregation would have told you, there is nothing about private property rights that makes them especially immune to this kind of behavior from public officials.

On reflection, the institutional ideal of dispersing power that underlies Friedman's argument is an attractive one, but his formulation is too simplistic. Robert Dahl offers a more sophisticated interpretation that covers a wider range of possibilities. According to Dahl (1989; see also Pettit 1997), a *polyarchy* is a society whose institutions are structured so as to disperse power and authority in such a way that many different groups in society are in a position, at some point in the legislative and regulatory process, to impose serious costs on officials when their felt interests and concerns are not addressed. Private ownership may well play a role in dispersing power in a liberal polyarchy, but many other mechanisms may contribute as well. For example, a robust array of NGOs, churches, and social organizations in civil society may provide a means for pressuring officials to respond to important social concerns. Legally mandated public consultations and public hearings in the legislative and regulatory process may give groups a way to pressure officials. Devolving power to states, townships, and municipalities may create more cross-cutting centers of power. And various measures to disperse decision-making power in the economy, such as codetermination in the firm or collective bargaining, would also create new avenues for contestation. An adequate form of liberal polyarchy would also have to incorporate various measures to inculcate a sense of justice in citizens, one that would help to ensure that they exercise their powers in defense of civil liberty rather than in pursuit of their own narrow self-interest (see Hussain 2009, 2012c).

2.6. The Neo-Lockean View of Market Powers

Before moving on, I want to say something about the neo-Lockean view of market powers associated with Robert Nozick and other libertarian thinkers. Following Rawls and Samuel Freeman (2001), I take it that the neo-Lockean view is actually at odds with the liberal ideal of a sphere of freedom for private individuals. Appreciating this tension should make it clearer how the liberal ideal is not as closely tied to the powers of ownership and exchange in a market economy as many people assume.

The neo-Lockean view starts with a certain characterization of the powers of private ownership and exchange in a market economy. It says that the various powers that people exercise in the market belong to a moral order of rights that is prior to and independent of social institutions. The powers of private property and exchange are natural rights, i.e., pre-institutional moral rights (Nozick 1974; Locke [1698] 1988; for a discussion, see Tully 1983; Waldron 1988; Freeman 2001; Murphy and Nagel 2004). On Nozick's account, natural rights of ownership and exchange place side constraints not only on the authority of governments, but on the whole institutional order in a political community.

Now consider the following possibility. Suppose that a liberal democracy defines powers of ownership and exchange in the way that is typically advocated by neo-Lockean thinkers. Suppose further that a small business elite emerges in a liberal market democracy and slowly acquires ownership rights in almost all of its books, libraries, scientific discoveries, and means of communication. Under these conditions, the business elite could exercise their powers of ownership in ways that prevent people from forming their practical identities in a rational fashion (e.g., by consulting the relevant scientific literature and evidence), discussing ideas with one another, and organizing their lives consistently with their rationally formed beliefs.

According to the Rawlsian interpretation, the liberal ideal of a sphere of freedom for private individuals requires that a social order must provide people with a fully adequate scheme of basic liberties. Among these liberties is the freedom of thought and discussion, which ensures that people can form and revise their practical identities in light of the relevant evidence. It follows that if the free exercise of neo-Lockean property rights could threaten the freedom of thought and discussion, we have a conflict between a *basic liberty* (i.e., liberty of conscience) and a *nonbasic liberty* (i.e., nonpersonal property). Here the liberal ideal would require that the social order redefine the legal powers of private ownership in ways that secure the liberty of thought and discussion (Rawls 1993a; Freeman 2001).

Among other things, a properly structured social order would incorporate various measures to ensure wide public access to books, scientific knowledge, and the means of communication. One possibility would be for a social order to incorporate a "fair use" doctrine that guarantees public access to the relevant intellectual resources and does not give owners the power to deny people certain forms of access to these resources (e.g., citing its contents). An effective "fair use" doctrine would apply even in cases where an individual produces a certain book, scientific theory, or fiber optic network with her own labor power and voluntarily transfers ownership of the resource to the business elite.

By contrast, the neo-Lockean view would rule out a "fair use" doctrine and most any other measure along these lines. A legislature could not adopt a "fair use" doctrine because doing so would invade the natural rights of ownership that people exercise over the fruits of their labor and the things that they acquire through consensual transactions with others. I find this view highly implausible. Whatever the importance of people having control over the fruits of their labor and having the right to engage in consensual exchanges, it is hard to see how the importance of these powers could be *insensitive* to the importance of the freedom of thought and discussion and insensitive to the importance of people's being able to rationally form and revise their practical identities. If someone argues that we must provide people with an extensive array of property rights, regardless of how these institutional powers relate to other values and concerns, we should reject the argument as *fetishizing* these forms of control. Any reasonable conception of private property must relate these forms of authority to deeper values, and thereby accept the possibility that a social order would have to modify and structure these institutional powers in light of these underlying concerns.

2.7. Summary

My aim in this chapter was to show that the liberal ideal of a sphere of freedom for private individuals is not as closely tied to the powers of ownership and exchange in a market society as people sometimes assume. A society could provide people with a fully adequate scheme of basic liberties, including the powers of personal property, whether it has an economy based on private property and market exchange, an economy based on collective ownership and market exchange, or an economy with some more democratic form of corporate governance. The liberal ideal is therefore "indifferent" between some of the most important possibilities for economic life.

The indifference thesis reflects a more basic distinction between two different justifying rationales for economic powers in a modern liberal democracy. Some of the institutionally defined powers that citizens exercise in a market society are constitutive of the basic liberties. As such, economic institutions must incorporate certain features, such as the powers of personal property and certain forms of authority with regard to purchasing decisions. But once the basic liberties have been secured, economic institutions in a modern liberal democracy must answer to a different justifying rationale. These institutional arrangements constitute a social coordination mechanism, a way of getting ourselves organized to produce and consume things in certain ways. Economic institutions must be designed to draw citizens into certain patterns of production activity and certain patterns of consumption activity. In an advanced market economy, this conception of institutional powers in the economic realm is more or less explicit, as the powers of ownership, exchange, contract, etc. are understood as serving the aims of economic efficiency, i.e., maintaining an efficient pattern of production and consumption. Much of the task in the chapters that follow will be to show that economic institutions must not only draw citizens into certain patterns of economic activity; they must do so in ways that are consistent with mutual respect, i.e., with citizens respecting themselves and one another as free persons. This Kantian ideal for social institutions supplements the liberal ideal that has been the focus of this chapter.

3

Social Coordination through a Dynamical System

Discussions of the relationship between markets and freedom often fail to clearly separate the liberal ideal of a sphere of freedom for private individuals from the full range of institutional powers associated with private property and exchange in a market society. In order to clear the way for a better discussion of the issues, I spent the previous chapter developing a more careful account of the relationship between the liberal ideal and the powers of private ownership and exchange. Once you see that the liberal ideal is indifferent between a wide range of different economic arrangements, it becomes clearer that the institutional powers that make up a market economy play a distinctive role in a modern liberal democracy: they form an institutional mechanism for drawing citizens into a certain pattern of production activity and consumption activity. An advanced market economy is, in essence, a *coordination mechanism*, a way of getting ourselves organized to produce and consume things in a certain way.

At the most basic level, the relationship between markets and freedom turns on a philosophical question about how a coordination mechanism answers to the value of freedom. Starting in this chapter, I will develop a conception of the relationship between markets and freedom that focuses on this issue. The new conception involves a number of ideas that work together to shift our perspective decisively from the Lockean outlook that shapes a great deal of philosophical theorizing about market life.

I will set out the main features of the new conception in chapters 3 to 6. The view consists of a series of claims about an advanced market economy. Sophisticated readers will recognize and accept many of these claims, but in order to fully appreciate their implications, you have to put them together to see how they require a different approach to the issues. In this chapter, I will develop a basic characterization of an advanced market economy as a mechanism of social control. In the next two chapters, I will develop a theory about when mechanisms of control of this kind are consistent with mutual

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respect among citizens as free persons. In chapter 6, I will show that social orders that incorporate an advanced market economy typically fall short of the ideal.

3.1. An Advanced Market Economy Is a Complex Value-Creating Social Institution

Let's start with some basic facts. The average grocery store in the United States carries over 39,500 items.[1] Each of these items consists of from as few as one or two ingredients to more than 50. These ingredients come from all over the country and from far-flung regions of the world. It is hardly a coincidence that half a million ingredients or more have come together from across the face of the earth to form a particular set of items on the store shelves. The ingredients have come together in this way, in part, because a complex system of background institutions draws producers into a certain pattern of production activity. The most important of these institutions is the market.

An advanced market economy consists, in part, of a shared understanding among the members of a community about how they are supposed to think and act in various circumstances (see chapter 1). When I go to the grocery store, a complex understanding informs my activity and the activity of everyone else in the store. Among other things, we all understand the basic powers and prerogatives of private ownership. We understand how the institutional power to "buy" and "sell" goods can change everyone's obligations with regard to the items that are bought and sold. And we understand the requirements of mutual disinterest—i.e., I must withhold my labor and goods from others until they offer me something of value in return, and I expect others to withhold their labor and goods from me until I offer them something of value in return.

The grocery store itself is part of a wider domain. The store purchases goods for sale from milk producers, coffee producers, bakeries, and cola companies, and everyone involved in these enterprises adheres to the requirements of private ownership, exchange, and mutual disinterest. A very large sphere of social life in our society is characterized by adherence to these requirements, and the grocery store is part of this domain.

[1] FMI, "Supermarket Facts," accessed September 5, 2022, http://www.fmi.org/research-resources/supermarket-facts.

The key point is that when I go to the grocery store and find a tub of my favorite ice cream sitting on the store shelf, *this is not like picking an apple from a tree*. The ice cream sits there in part because a complex social institution prepares the way for me to find what I want. As people in our society adhere to the requirements of private ownership, exchange and mutual disinterest, we collectively create a social context in which producers can realize certain gains for themselves by using their resources to produce the ice cream that I like. And we collectively create a social context in which consumers such as myself can realize certain gains by coming to the grocery store ready to offer something in exchange for the goods that we want.

The shared understanding that constitutes an advanced market economy goes far beyond private ownership, exchange, and mutual disinterest. It encompasses a much wider array of institutional rights, duties, and powers, including the rights of contract and employment, the power to form a business corporation, the rules of product liability, the rights of intellectual property, the power of central banks to issue currency and manage the money supply, and a range of rules that link the market arrangement in our society with similar arrangements in other societies.[2]

The most obvious illustration of the complex institutional background is money. The physical currency in the United States is manufactured by several thousand people working in the US mint and the US Bureau of Engraving and Printing. The money supply more generally is created through the banking and credit system, which is managed at the highest level by the 19,000 or so people working in the US Federal Reserve System. Currencies around the world, including the US dollar, the Canadian dollar, the Chinese yuan, and the euro, are exchangeable with one another, and the relative stability of exchange rates is maintained by the activities of commercial banks, financial institutions, currency exchanges, central banks, and international organizations such as the International Monetary Fund. Many more layers are involved when you think about the importance of credit cards and various computerized systems of payment.

If you go to the grocery store and find your favorite brand of Ethiopian coffee on the shelf, the coffee sits there, in part, because the global currency system stands in the background. The currency system creates the conditions in which your desire for a certain kind of coffee can shape the

[2] I follow Aaron James (2014) in treating the global market as an interconnected system of domestic markets. This "multilateral" view of the global market (and global institutions) is not essential to my argument, however, and my account is compatible with more cosmopolitan views.

opportunities available to growers in Ethiopia. It creates a context in which your desire presents a meaningful opportunity for the growers—as well as for the suppliers, roasters, and a raft of middlemen—to secure certain gains for themselves by performing the activities necessary to turn the beans into coffee and to get the coffee to the store shelf.

The grocery store shelves are also packed with intellectual property. The ice cream, the coffee beans, and most of the other products in the store contain various chemical preservatives and artificial sweeteners, and they also carry various appealing brand identities. These preservatives, sweeteners, and brand identities exist, in part, because there is a shared understanding of intellectual property operating in the background, an understanding that is legally recognized and enforced throughout much of the world. This understanding helps to maintain the social conditions in which companies can secure benefits for themselves by making the enormous investments in research, development, and marketing that go into the products that you see.

3.2. An Advanced Market Economy Is a Social Coordination Mechanism

An advanced market economy is a complex institution. Like a game, it defines a certain kind of interaction among participants that is aimed at realizing an underlying objective. But there is an important difference. The public justifying rationale for games such as baseball or Monopoly is to have fun: the form of interaction defined by the rules is supposed to be enjoyed for its own sake—i.e., it is supposed to be inherently pleasing, exciting, challenging, etc. But the public justifying rationale for an advanced market economy is not to have fun. The form of interaction defined by the rules is not supposed to be enjoyed for its own sake—it's nice if people enjoy it, but that's not the main point. The interaction defined by the rules has a certain *social purpose*, namely to coordinate production activity and consumption activity in society in an economically efficient way. I will say more about this public justifying rationale in section 3.10. For now, I want to look more closely at how the form of interaction defined by the rules typically achieves this justifying aim.

On the one hand, the form of interaction defined by a market economy creates an evolving choice-context for producers. If the desire for a certain type of ice cream declines in society, the choice context faced by the producer of the ice cream in a well-functioning market arrangement will change. The producer will find that she has good reason to withdraw resources from the production of this type of ice cream and to reallocate these resources to other productive activities. She may do this directly by using these resources to produce some other good (e.g., a new flavor of ice cream) or indirectly by purchasing fewer resources, thereby freeing up these resources for some other producer to use. The changing choice-context has an impact on what producers do, and ultimately on what consumers see on the store shelves.

On the other hand, the form of interaction defined by a market economy creates an evolving choice-context for consumers. If the social cost of producing a certain type of ice cream increases, the choice context for consumers in a well-functioning market economy will change. The consumer will find that she has good reason to rethink her consumption activities, switching to a different flavor of ice cream or eating less of the same flavor, thereby freeing up resources to be allocated to the production of other goods. The changing choice-context has an impact on what consumers do, and ultimately on what possibilities producers face.

We might put the point more forcefully by saying that an advanced market economy is a mechanism of *social control*. The institutional features of an advanced market economy are structured in such a way as to shape what we do at work, what we do in our kitchens, and what we do on our daily commutes: the institution continuously draws us into certain patterns of production activity and consumption activity. In saying that the market is a mechanism of social control, I am not saying that the market commands people to do certain things or coerces people to do certain things. A market economy is a far more subtle and sophisticated form of social control that works by constantly adjusting and readjusting the choice contexts that individuals face. Let me elaborate.

3.3. Market Activities Form a Dynamical System with a Stable Equilibrium Point

Let's distinguish between the *institutional powers* defined by a market economy and *market activity*. Among other things, a market arrangement defines various institutional powers, such as the power to buy and sell goods. "Market activity" consists of (a) actors exercising their market powers (i.e., buying, selling, contracting, etc.) and (b) actors carrying out an activity or a set of activities with a view (at least in part) to securing some benefit through the exercise of their market powers. Here are some examples of market activity: my buying a tub of ice cream from the grocery store; my working to earn enough money so I can buy ice cream; and my turning down the thermostat in my house so as to save money on my heating bill, thereby freeing up resources to spend on other market purchases, such as a tub of ice cream.

When we consider all of the market activities in a liberal democracy together, these activities form a *dynamical system*. The theory of dynamical systems in mathematics is highly developed, but a few basic ideas are all that we need for my purposes (see Strogatz 2014; van Gelder and Port 1995; Beer 2014). A dynamical system is a set of interacting elements that can be distinguished from the rest of the world. A system has various possible states, each state consisting of a set of facts about the interacting elements. The behavior of the system follows an "evolution rule" that describes future states of the system given its current state. A system is autonomous when future states of the system are determined exclusively by its previous states. A system is nonautonomous when future states of the system are determined not only by its previous states but also by external conditions.

Some dynamical systems have a stable equilibrium point. This means that there is some state of the system (or multiple states) such that, whenever an external factor moves the system out of this state (within some range), the system will move through a series of intermediate states until it returns to the equilibrium state. For instance, the stable equilibrium of a pendulum system is the state in which the pendulum is at its lowest point with no angular momentum. If you push the pendulum, moving the system out of its equilibrium state, the system will move through a series of intermediate states, until eventually the pendulum reaches its lowest point without any angular moment. The system then remains in this state until something from the outside disturbs it.

The vast array of market activities in a modern liberal democracy form a dynamical system. The states of the system correspond to potential patterns of market activity, most importantly to potential patterns of market-oriented production activity and market-oriented consumption activity.[3] These

[3] *Market-oriented production* consists of activities that are undertaken in order to create a good or service and to secure a benefit by selling this good or service for financial benefit. *Market-oriented consumption* consists of activities that consume a good or service, where the consumption is oriented in light of some view about what can be purchased in the market now or in the future (i.e., purchased from producers who are oriented toward production for sale). From now on, whenever I use the term "production activity" or "consumption activity" without qualification, I am

patterns consist of facts such as "Person A makes 100 silicon chips in the lab" or "Person B heats his house to 72°F."[4] The system is nonautonomous because the pattern of production and consumption activity at any given point in time is determined not only by production and consumption activity at a previous point but also by external factors, such as individual preferences, the availability of natural resources, and the state of technology. In effect, external facts establish certain parameters, and the system follows an evolution rule that delineates the trajectory of the system given these parameters.

Market activity is a dynamical system that, under certain conditions, has a stable equilibrium point. Under the idealized conditions assumed in certain forms of economic theory, the equilibrium point is a pattern of production activity and consumption activity that is *economically efficient*. For the purposes of this chapter, I define economic efficiency in terms of Pareto optimality: a society-wide pattern of production activity and consumption activity is "economically efficient" when there is no other feasible pattern such that at least one person in society would be better off given that pattern and no one else would be worse off (where "better off" and "worse off" are understood in terms of the satisfaction of an individual's self-regarding preferences).[5] Under idealized conditions, the equilibrium state for market activity is a pattern that is Pareto optimal for the current members of society.[6]

referring to market-oriented production and market-oriented consumption. (For a discussion, see the appendix.)

[4] Explanations of market behavior in microeconomics tend to focus on flows of *goods*, articulated in terms of supply functions and demand functions. Though this is appropriate for the purposes of understanding and making predictions about prices and related social phenomena, to bring a certain set of moral questions into focus, we need to shift our perspective from flows of goods to the complexes of human activities that create these goods and make use of them. I take it that any supply function or demand function stated as part of a theory that explains the behavior of a particular set of economic activities corresponds to a set of dispositions among social actors to *make* certain goods or *consume* certain goods given certain choice-contexts. It follows that we can translate a theory that is articulated in terms of supply functions and demand functions into a theory that is articulated in terms of the dispositions of social actors to act in certain ways given certain choice contexts.

[5] Let me note here that, even under ideal conditions, market exchanges are typically Kaldor-Hicks improvements rather than Pareto improvements. But I will assume for the purposes of the argument that Kaldor-Hicks improvements generated by the market are also Pareto improvements. That is, if a market interaction leads to a Kaldor-Hicks improvement and therefore a *potential* Pareto improvement, the interaction occurs in such a way that this potential Pareto improvement is what actually happens. No doubt, this is a very serious idealization, but it is one that is common in economic policymaking debates. My point in making this assumption is simply to bracket off certain standard criticisms of the market in order to focus on another dimension of moral analysis, i.e., mutual respect and authoritarianism.

[6] The idealizations that inform economic theory can be more or less extreme when it comes to externalities between generations. The more extreme view assumes that there are no externalities, while the less extreme view allows for certain kinds of externalities, such as intergenerational environmental externalities. The less extreme view is typically part of a broader theory in which the

In what follows, I will assume that actual social conditions approximate the idealized conditions well enough that the standard economic analysis describes a central tendency of market activity in the real world.[7]

To illustrate, imagine a society in which the current state of market activity is economically efficient. Suppose that someone discovers a new technology and it is now possible to produce the same amount of ice cream with less electricity. With this discovery, the current state of market activity is no longer efficient, as there is a new pattern of feasible production activity that would produce the same amount of ice cream with less electricity, where the electricity savings are used to produce more of some other good that citizens want or need. Insofar as market activity is a dynamical system of the kind I have described, production and consumption activity will move through a series of intermediate states until it reaches a state that takes advantage of the new possibilities. Once the system reaches a state that is economically efficient given the new circumstances, it will come to rest in this new configuration (or some narrow orbit of similar configurations).[8]

When you ask most philosophers about the nature of market activity, they will readily accept statements such as the following:

The market is efficient.
Markets have equilibrium states.
Interaction in the market tends toward an equilibrium state that is Pareto optimal.

function of the regulatory state is, in part, to deal with these externalities, if only by defining a "complete" set of property rights (see, e.g., Coase 1988a). My main target in this chapter and the next two is the standard conception of market democracy (see chapter 5), so I assume that the actual conditions in society approximate the less extreme view.

Allowing for intergenerational environmental externalities means that the actions of individuals in the current generation can impose costs (or benefits) on those in future generations, where these costs (or benefits) are not reflected in current prices. It follows that the stable equilibrium state for market activity is a pattern of production activity and consumption activity that is Pareto optimal with respect to all existing members of society, but not necessarily optimal when we take into account the preferences of members who do not exist yet (i.e., future generations). The market equilibrium may be a pattern such that it is possible to reorganize this pattern to make someone in the future better off, without making anyone else worse off.

[7] The point of this assumption is to bracket certain well-known objections to the standard economic arguments in favor of market coordination (e.g., that market activity in the real world never reaches an equilibrium state) in order to focus on a different set of moral issues raised by social institutions that do in fact coordinate human behavior by means of a dynamical system.

[8] Of course, for any set of external facts, there may be many different patterns of production activity and consumption activity that satisfy the criteria of economic efficiency. In other words, market activity is a dynamical system with multiple equilibria and many factors will play a role in determining which of these is realized at any given point.

That is to say that most philosophers accept the main elements of the economic analysis of market activity as a dynamical system.

What is striking, however, is that philosophers rarely engage in theoretical reflection about the market from the perspective of an individual who is herself *a part of the system*. In the usual case, philosophers will note and accept that market activity in a liberal democracy forms a dynamical system, but they will do so from the perspective of an outsider observing the operation of a system that has this property. This is the perspective of an economist or a policymaker who monitors market behavior and uses various statistical and modeling techniques to predict how different changes in social circumstances might change observed patterns of activity. But the philosophical importance of the idea can be appreciated only by taking up the point of view of a participant, someone formulating and carrying out her plans, who is herself a part of a system that operates in this way.

3.4. Changes in the Overall State of Market Activity Come About through Changes in Individual Choice-Contexts

Most of us live in societies where markets coordinate a vast array of activities. Assuming that real-world conditions approximate the idealized conditions to a sufficient degree, the standard economic analysis implies that these activities form a dynamical system, one that has a stable equilibrium point. If we take the economic analysis seriously—as we should—it follows that our own market activities and the market activities of those around us form a dynamical system of this kind. Our activities and the activities of those around us are constantly changing and adjusting in ways that move toward a pattern of activity that is economically efficient. And whenever there is a change in social conditions that pushes us off the "efficiency frontier," our activities will start adjusting to these new conditions until our activities once again realize a pattern that is economically efficient.

How do these changes in production and consumption activities come about? With some dynamical systems, such as the solar system or the population of fish in a pond, the behavior of the system is the product of nonintentional physical or biological processes. Market activity is different because the behavior of the system is substantially the product of intentional human activity. So overall changes in the state of market activity come about because individuals decide that they will change their conduct in ways that correspond to the systemic behavior.

What leads people to make the relevant changes? I take it that individuals make these changes because the choice contexts that each actor faces change in ways that lead her to make the relevant changes. If the equilibrium state for market activity is an economically efficient pattern of production and consumption activity, then it must be the case that whenever some external shock moves the system off the "efficiency frontier," there is a cascading series of changes in the choice contexts that actors face that eventually leads them to adjust their activities in the ways that are necessary to reach a new pattern of production and consumption activity that is economically efficient.

Suppose, e.g., that I am an ice cream producer happily making ice cream to sell to a grocery store. One day there is an influx of new workers into the economy. What follows is a cascading series of changes in the choice contexts of market actors. A car manufacturer may find itself with a new opportunity to hire a factory worker at a lower wage. This might release a worker who used to be employed by the manufacturer, who then finds employment at an amusement park. Other workers laid off at the amusement park may find employment at restaurants, shipping companies, or dry cleaners. These rippling adjustments will eventually make their way to me, where they will appear as a drop in the price of labor, i.e., a new set of options to hire workers at a lower cost. When I take advantage of this opportunity, the cascade of adjustments continues, as I may offer new options for consumers to buy ice cream at a lower cost. Eventually, these adjustments come to an end when the system reaches a new equilibrium, and from that point on the system makes only minor adjustments to maintain the equilibrium state.

3.4.1. The Invisible Hand

The preceding analysis gives us a basic theoretical account of perhaps the most important sociological phenomenon associated with the market, namely the invisible hand.

In *The Wealth of Nations*, Adam Smith ([1776] 1937, 421) first uses the term "invisible hand" in describing a case in which a merchant pursuing profits "intends only his own gain, and he is . . . led by an invisible hand to promote an end which was no part of his intention" (see also Rothschild 2001). The end that the merchant promotes unwittingly is the augmentation of public welfare. Smith regards the fact that the merchant promotes public welfare as a good thing, and so his account of the invisible hand—like many other accounts—takes for granted certain normative principles regarding welfare and the public good. But for my purposes, it is important to have a characterization of the phenomenon that is more neutral as to the reasons that might make the invisible hand morally significant.

Luckily, Robert Nozick (1974, 18–22; Nozick 1997; see also Lindblom 2001) offers just such a neutral characterization. Nozick notes that when we observe complicated patterns in the world, it may seem to us that these patterns could come about only through an intentional effort to maintain the pattern. But an "invisible hand process" is one that can generate and maintain a complex pattern without anyone intending to generate or maintain the pattern. Nozick cites equilibrium processes as one example of an invisible hand process. In an equilibrium process, "each component part responds or adjusts to 'local' conditions, with each adjustment changing the local environment of others close by, so that the sum of the ripples of the local adjustments constitutes or realizes [the pattern]" (Nozick 1974, 21).

The invisible hand process that we observe in a market economy is one instance of what Nozick calls an "equilibrium process." When we see a society-wide pattern of production activity and consumption activity that is economically efficient, we may think the pattern must have been the product of an intentional effort by the individuals involved to organize their activities in this way. But, in fact, the individuals involved do not intend to organize their activities in an efficient way; the society-wide pattern is substantially the result of an equilibrium process. The component parts correspond to market actors, each adjusting to the local opportunities presented to them by the choices of other market actors. The choices of each market actor then go on to change the local opportunities faced by yet other market actors. And the process of rippling adjustments continues until the system comes to rest in a society-wide state of production activity and consumption activity that is economically efficient.[9]

[9] Market activity exhibits a systemic behavior that is not intended by market actors: individual producers and consumers do not intend to adjust their production activities and consumption activities so as to maintain an overall pattern that is economically efficient. When market activity is understood as the operation of a complex social institution—i.e., an advanced market economy—the pattern is unintended by market actors, but not unintended by other actors in the arrangement. An advanced market economy incorporates a public justifying rationale that guides the activities of officials in managing the operation of the institution and interpreting and developing its rules. When everyone does their part in the scheme, they collectively sustain the conditions for the systemic behavior. I discuss the public justifying rationale for an advanced market economy further in section

3.5. Changing Choice-Contexts Appear to Individuals Taking Part in Market Activity as Changing Prices (and Wages, Profits, Etc.)

As social conditions change, market-oriented production activity and consumption activity constantly find their way back to an economically efficient pattern. What leads people back into a pattern of this kind are the changing choice-contexts faced by each individual actor. In the usual case, however, people do not see the changes in their choice contexts explicitly labeled as "Changes in Choice Contexts." In the usual case, people see these changes as changes in prices.

The price system, as I understand it, includes all of the prices for the various goods that individuals and firms may purchase in society. At the same time, the price system includes all of the prices for the various forms of labor that can be purchased—this includes both the price that your labor currently commands in the market and the price that my labor currently commands in the market.[10] It is easy to misunderstand the significance of prices when we think about them from the perspective of consumers simply looking to spend a certain amount of money that we already have. Most of us have a certain amount of money to spend because our labor commands a certain price in the market. This means that we are absorbed into market activity not only as consumers *but also as workers* (or investors, entrepreneurs, etc.). The market shapes both what we can do with the money that we already have and the amount of money that we have in our hands in the first place. Prices are an encompassing phenomenon that fundamentally shapes the social world that each one of us faces.

At any point in time, an individual's income (or potential income) and the prices of various goods and services in the market together constitute a complex set of options that are open to that person: they constitute her *option set* (Cohen 2011b; Sen 2002; Daniels 1975). For example, my income and the price of a plane ticket to Hawaii together determine whether I have the option of flying to Hawaii. If my income falls or the price of a plane ticket rises, I may no longer be able to buy a ticket. Without a ticket, I could go to the

3.10. For a discussion of intended and unintended aspects of market activity, see Sen (1984b; 1999, 254–61).

[10] By extension, the price system also includes the profits (and potential profits) that firms might generate in following certain production and marketing plans rather than others.

airport and try to board a plane, but the company would refuse to let me on, and the police would eventually arrive, applying the coercive power of the state to prevent me from boarding.[11] This application of state power ensures that certain "doors" are closed to me when I lack the relevant financial resources (Cohen 2011a; Daniels 1975).

Prices in the market are constantly changing, often too slowly for us to pay much attention. The prices of various goods and services are changing, as are the prices of various forms of labor. In the sense that I just described, changes in wages and prices represent changes in the option sets open to us. In effect, options are constantly changing and disappearing in each of our option sets, and in a well-functioning market arrangement these options are appearing and disappearing in such a way as to draw producers and consumers into a certain pattern of activity, i.e., a society-wide pattern of production activity and consumption activity that is economically efficient.

3.6. A Coordination Mechanism That Continuously Draws People into a Certain Pattern of Activity by Means of a Changing Array of Choice Contexts May Subject the Individuals Involved to an "External Process"

Changing wages and prices are constantly opening and closing "doors" for individuals, altering the possibilities that are open to us. Moreover, the price system is opening and closing doors in such a way as to draw us into a certain pattern of activity, namely a pattern of production activity and consumption activity that is economically efficient.

An array of changing option sets that is directed toward maintaining a certain society-wide pattern of activity may subject the individuals involved to an external process. I define *subjection to an external process* as follows:

> Members of a group $\{I_1 \ldots I_n\}$ are subject to an external process P when P determines some aspect of the activities of $\{I_1 \ldots I_n\}$, but P does not involve the rational deliberations of each member of the group in such a way that this aspect of the group's activities could be attributed simply to the sum of the private choices of $\{I_1 \ldots I_n\}$.

[11] If you have any doubts about the use of violence: https://www.youtube.com/watch?v=F6Ig qYBSYFo.

Subjection to an external process is not itself something that violates a moral ideal. But the concept is important for my purposes because subjection to an external process is a component part of a more complex phenomenon that may violate a moral ideal. I will discuss the more complex phenomenon below and in the next chapter.

For now, let me illustrate the idea. Here is an example of a situation in which a changing array of option sets can subject individuals to an external process:

> **Mice in a Maze.** Three mice are in a behavioral science lab. The mice are in an enormous maze. The maze has doors at many junctures that can be opened or closed remotely. A scientist sits at the controls. At each point in time, the mice have different options open to them—go straight, go left, go right, go back, etc.—but the scientist can shape their option sets by opening or closing various doors. The scientist always ensures that each mouse has more than one option open to her. But by opening and closing the doors in the right sequence, the scientist leads the mice into a certain pattern of activity: the scientist leads them into a pattern in which the three mice keep meeting each other at regular intervals.

Let's assume that the mice are extremely intelligent and that we can enter into their perspectives. From the point of view of each mouse, every choice that the mouse makes from the options available to her would be her own choice, in the sense that these choices were not the product of coercion, brainwashing, or some similar choice-undermining phenomenon. Nonetheless, the pattern of activity that the mice find themselves in—a pattern in which they keep running into each other—is not something that is wholly attributable to the private choices that the mice make from within these option sets. The reason is that their option sets are constantly being *set up* in such a way as to draw them into the pattern, and the pattern of activity is mainly attributable to the process that continually adjusts and readjusts their option sets. So in the sense that I described earlier, the mice in the maze are subject to an external process.

Two features of the example are worth noting. First, the process controlling the option sets of the mice in the example is a human agent, i.e., the scientist, who acts with the intention of drawing the mice into a certain pattern. However, subjection to an external process, in my sense, does not require that the process be a conscious human being, intending to bring about the pattern. All that is required is that a process P determines some aspect of the activities of the members of a group, where P manages the contexts for individual deliberation by members in such a way that this aspect of their activities is not properly attributable to the sum of their private choices. I use the lab mice case to make the phenomenon more vivid, but in a moment I will use an example that involves a process P that is not a conscious agent.

Second, the fact that the mice in the lab mice case are subject to an external process may be *obscured* by the fact that the external process involves an array of changing option sets. Since each mouse has a set of options open to her and since she makes a choice from among these options, it would be natural for each mouse to think that the overall pattern of activity—i.e., their meeting up regularly—was simply the result of the sum of their private choices as individuals. But, in fact, the mice have been led into a certain pattern by an external process. It is this external process that constantly adjusts and readjusts their option sets to encourage a certain pattern of activity to emerge through their private choices.

What holds for the mice in the lab also holds for human beings. Consider the following:

> **Traffic Lights.** You are driving a car in downtown Toronto. A complex system of traffic lights coordinates your driving activity and the driving activity of all of the other drivers on the road. Each red light you face is a set of options that are closed to you. Each green light you face is a set of options that are open to you. All of the other drivers face red lights and green lights that shape their option sets in similar ways. A computer program runs the traffic lights, constantly changing the lights from red to green to red in order to draw everyone into a certain pattern of activity: the smoothest flowing use of the road system possible. One day there is a software glitch and the lights do not operate in their normal way. The lights now draw people into a convergent pattern, funneling everyone toward Bloor Street.

Imagine you are stuck in traffic on Bloor Street. Looking around at the other drivers, you might think that the overall pattern of activity you are all involved in—i.e., the traffic jam—is simply the result of the sum of the private choices that each of you made to drive at a certain time or to a certain destination. Each of you might think this way, but in fact, the convergent pattern of activity is not attributable simply to the sum of your private choices. It is attributable rather to the process P—the glitchy operation of the software—that draws everyone into a pattern in which they all take the same road. In the sense that I described, you are all subject to an external process.

I should emphasize that subjection to an external process is a common phenomenon, and most of us find ourselves subject to all kinds of external processes. Photosynthesis, e.g., is an ongoing process that shapes plant life on earth, thereby shaping the food chain and ultimately the choices that we face in the grocery store. In a very fundamental way, photosynthesis shapes our eating patterns by shaping our option sets, making available to us certain foods rather than others. Subjection to an external process as such is not something that is morally objectionable. But subjection to an external process is a component element in a more complex phenomenon that may be morally objectionable. This more complex phenomenon is a social institution that is structured in such a way that participants *subject* themselves and one another to an external process, often without realizing it. I will discuss this phenomenon below and in the next chapter.

3.7. An External Process Can Draw Individuals into a Certain Pattern of Activity in a Way That Bypasses the Practical Judgments of These Individuals about the Pattern

I want to highlight an important feature of external processes and the way that they can shape our lives. When a group of individuals are subject to an external process, the process manages their option sets in such a way as to draw them into a certain pattern of activity R. An important feature of this kind of process is that it can generate the pattern R in the activities of individuals in a way that bypasses the practical judgments of these individuals about the merits of R.

Consider the traffic lights example. Imagine that you and the other drivers on the streets of downtown Toronto believe that traffic jams are a horrible waste of time. You judge, all things considered, that a traffic jam is not a pattern of activity that you or any other citizen should take part in. Given the opportunity to decide collectively where Toronto residents will drive and how they will reach their destinations, you and your fellow drivers would decide on almost any pattern of activity except a traffic jam. But if there is a software glitch, the traffic lights in the city may open and close "doors" for you and the other drivers in such a way as to draw all of you into a traffic jam, despite your private judgments that this is not an attractive pattern of activity.[12] An external process can maintain a certain pattern R in our activities in a way that bypasses our practical judgments about R, and this feature of external processes will be important when we turn to the moral assessment of certain social institutions.

3.8. Some Coordination Mechanisms Subject Individuals to an External Process without a Discrete Control Component

People are subject to an external process when a changing array of option sets draws them into a certain pattern of activity R, but the pattern cannot be attributed simply to the sum of their private choices. Among the social circumstances in which people may be subject to an external process, I want to draw attention to one in particular.

Members of a society sometimes find themselves involved in a *structure of mutual adjustment* (see Lindblom 2001). A structure of mutual adjustment is an institution whose rules are structured so that the choices each participant makes from within her option set help to define the option sets open to the other participants in an iterative process. As each participant makes a choice from within her option set, this changes the option sets open to some of the others. Participants with changed option sets then make choices that lead to further changes in people's option sets and further choices. The process continues this way, and under certain conditions it will come to rest when all of the participants have been drawn into a certain overall pattern of activity.

[12] Some might point out that part of the problem in this case is that the drivers do not have access to information about the intentions of other drivers: each driver knows only her own intended destination and the various routes that she might take to get there. Without information about the intentions of other drivers and without adequate means of communication, the drivers cannot effectively coordinate their activities with one another and avoid the traffic jam that they all abhor. So, in a sense, the traffic lights seem *superfluous*: the drivers cannot avoid ending up in traffic jams from time to time, even if there were no traffic lights in the city.

It may be true that drivers would end up in traffic jams with or without the traffic lights, but this is beside the point. After all, once the traffic lights are up and running in the city, the lights could draw the drivers into many traffic jams that would not have occurred in the absence of the lights. For instance, the traffic jam that occurs when the software malfunctions is very likely a traffic jam that would not have occurred in a world without traffic lights. In this way, we see clearly that the traffic lights can draw drivers into certain patterns, regardless of their private judgments about these patterns.

When a structure of mutual adjustment is sufficiently large, the process that draws participants into a certain overall pattern of activity will appear to each of them simply as a constantly changing option set. Suppose you are a participant in a very large structure of mutual adjustment. You start with a set of options and make a choice. Eventually thousands—sometimes millions—of unseen choices by other participants present you with a new option set. You make another choice. Your option set changes again. And again. And again. Your changing option set draws you into a set of activities that is consistent with the overall pattern. But importantly, you cannot survey the operation of the structure as a whole: you see only your changing option set. Much the same holds true for each of the other participants: they each see only their own changing option sets, and these option sets are what draw them into activities that are consistent with the overall pattern.

What makes a structure of mutual adjustment different from other cases in which people are subject to an external process is that there is no discrete component of the system that controls everyone's option sets in a centralized way.[13] In "Mice in a Maze," there is a discrete component—i.e., the scientist—that manages the option sets open to the mice in such a way as to draw them into a certain pattern. In "Traffic Lights" the signal software does the same for the drivers. But there is no discrete component in a structure of mutual adjustment that is analogous to the scientist or the signal software. The control mechanism in this case is "dispersed" throughout the system: the rules of the institution are structured in such a way as to ensure that participants keep generating option sets for each other that eventually draw everyone into the overall pattern.

An illustration will help to make the preceding more concrete:

Gym Class. You are a student in a high school gym class. Young people your age need to run about the length of the soccer field each class in order to stay healthy. It turns out that people your age playing a decently competitive soccer match will run about the length of the soccer field over the course of a class period. In order to ensure that everyone gets the right amount of exercise, the rules of the gym class incorporate a soccer match into every session, where the winners get a higher grade and the losers get a lower grade.

[13] The discussion in this paragraph and the chapter more generally draws on Haugeland (1985, 1998).

In the example, there is a shared understanding of how people are supposed to act in gym class, and this understanding defines a structure of mutual adjustment—in this case, a game. According to the rules, the choices that each student makes from within her option set affect the choices open to the others. As each student makes a choice from within her option set, this changes the option sets open to the others, which leads to more choices and more changes. Each student encounters the process as a changing option set that draws her into a certain overall pattern of activity, i.e., one in which everyone runs about the length of the field during class. But when the pattern emerges, it cannot be attributed simply to the sum of the private choices of the students; it is substantially the product of an external process that presents them with option sets that draw them into the pattern.

The presence of an external process in the context of a game is not often emphasized in contemporary political philosophy, so let's look at the soccer match more closely. Imagine you are one of the students playing on the soccer pitch. The actions of each of the other players present you with a set of options: pass to X, pass to Y, shoot, etc. Your choices within your option set then contribute toward establishing the option sets open to the other players. As you all play the game, your choice contexts are continuously evolving in ways that make it reasonable for you to do things such as chase the ball downfield or defend against an attacker. Over the course of the game, the evolving option sets open to each student will eventually lead all of you into a certain pattern of activity, namely a pattern in which each of you runs about the length of the field over the course of the class.

Notice that any time a student tries to act in a way that might prevent the overall pattern from emerging, her option set will change in ways that draw her back into the pattern. For instance, if you stand around doing nothing, an opposing player will see an opportunity to attack your team's goal. When the other player attacks, you have to chase the player down or else face the consequences of losing the game. So whenever a student slows down, her option set changes in ways that get her moving again. Everyone on the field is roped into an enterprise whose influence on her activities is very real but more subtle and difficult to pinpoint than in a centralized system of command and control.

3.9. An Advanced Market Economy Defines a Structure of Mutual Adjustment That Subjects Individuals to an External Process

Let's return now to the market. In an advanced market economy, citizens find themselves in a situation that is not unlike the students playing soccer in "Gym Class." A market arrangement consists in a shared understanding among citizens about how they are supposed to think and act in certain circumstances. The shared understanding defines a structure of mutual adjustment. If you are an individual in market interaction, what you see is an option set defined by prices and wages in the economy. This option set is open to you because other market actors (e.g., an ice cream company, an airline, past generations of consumers) have made certain choices. The choices you make from within your option set will then help to shape the option sets open to other market actors. As the process of mutual adjustment unfolds, your option set continuously evolves in ways that make it reasonable for you to do certain things, such as buy a certain kind of ice cream, fly to a certain vacation destination, or work at a particular firm. Over time, the evolving option sets open to each market actor will eventually lead everyone into a certain society-wide pattern of production activity and consumption activity, namely a pattern that is economically efficient.

Note that any time a citizen tries to act in a way that is inconsistent with economic efficiency, her option set will change in ways that draw her back into an efficient pattern. For instance, imagine that a citizen is working at a job that represents a socially valuable use of her talents, and she starts slowing down in her work effort. Other market participants will see an opportunity. As other market actors improve their performance, hoping to take her job, the citizen has to double down on her effort or else face the consequences of unemployment. Her option set changes so as to draw her back into a set of activities that are consistent with the overall pattern. In this way, citizens in a market arrangement are roped into an enterprise whose influence on their activities is very real but more subtle and difficult to pinpoint than in a centralized system of command and control.

I want to take a moment to emphasize the last point. Philosophers and economists often contrast a market economy with some form of bureaucratic central planning to highlight the decentralized nature of market coordination. The decentralized character of the market has many attractions; e.g., Friedrich Hayek ([1945] 1996, 1960) argues that the decentralized character of the market coordination process allows it to make better use of dispersed information and know-how to organize economic activity in an efficient way. But for my purposes, it is important to stress that the decentralized character of the market process does not imply anything about whether the market is *a mechanism of social control*. There may be no authority figure or central planner in a market arrangement who controls everyone's option set, but the rules of the arrangement are still structured in such a way as to present people with option sets that draw everyone into a certain overall pattern of activity. Adherence to the rules of a market arrangement may therefore embody a form of social control, even if the control mechanism does not fit the model of a centralized system of command and deference.

3.10. Economic Efficiency Is the Central Public Justifying Rationale for the Structure of Mutual Adjustment in an Advanced Market Economy

In an advanced market economy, there is widespread adherence to the requirements of private ownership, exchange, and mutual disinterest. Adherence to these requirements creates a structure of mutual adjustment in which market actors find themselves with constantly changing option sets, and these option sets evolve over time to draw everyone into a society-wide pattern of production activity and consumption activity that is economically efficient.

Some might argue that the tendency of a market arrangement to generate an efficient pattern of economic activity is merely an accident, an unintended side effect of market interaction. To develop the point, imagine that our basic institutions simply defined and enforced a Lockean scheme of property rights. Under this arrangement, each of us has various rights of private ownership and exchange, and as we exercise these rights in pursuit of our various ends, we might find that our exchange activity maintains a society-wide pattern of production and consumption that is economically efficient. But insofar as our institutions are structured simply to provide us with certain Lockean rights, this efficient pattern would be an unintended byproduct of our exchange activity and of our institutions more generally. There would be no sense in which the arrangement was "drawing" us into a certain pattern; the pattern is merely something that happens when you define and enforce a scheme of Lockean property rights.

The objection raises an important issue. The objection portrays market economies in such a way that certain systemic tendencies of these arrangements are not essential to their moral assessment. The problem with the objection, however, is that we do not live in an arrangement that simply defines and enforces a scheme of private property. Most of us live in societies with *advanced market economies*. In these arrangements, the tendency for market interaction to maintain a society-wide pattern of economic activity that is efficient is no mere accident or unintended side effect: it is central to the public justifying rationale for the enterprise. The difference between an advanced market economy and a simple private property regime is essential to understanding the moral nature of the economic system that we live in.

An advanced market economy, as I understand it, is a complex institution. On the one hand, the shared understanding that constitutes the institution defines a structure of mutual adjustment. This structure is an interactive arrangement, where each actor's choices from within her option set affect the option sets open to the others, and the arrangement draws everyone into a certain pattern of activity.

On the other hand, the shared understanding that constitutes the institution incorporates a certain public justifying rationale for the enterprise. The constitutive rationale is economic efficiency. The various elements of an advanced market economy are publicly understood to be justified insofar as they generate and maintain an economically efficient pattern of production activity and consumption activity. In the typical case, the public justifying rationale does not figure into the ordinary reasoning of most participants. Instead, it figures as an organizing principle in an authoritative system of public reasoning that guides officials as they exercise their various powers to manage the market and to develop its rules over time (see Rawls 2001, 137; O'Neill 1985, 122; see also Dworkin 1986; Scanlon 2003; Habermas 1996).

For many readers, the model of an advanced market economy as a complex institution will seem unusual. Why should we think of an advanced market economy as a complex institution with a public justifying rationale? The answer is that this model is the best "constructive interpretation" of advanced market economies as we know them (see Dworkin 1986). The economic arrangements that are my main concern in this book are the ones that we find in developed liberal democracies, such as the United States, Canada, and the various countries of the EU. In formulating a philosophical model of the type of arrangement that we find in these societies, we must be sensitive to considerations of fit and justification. On the one hand, a philosophical model must fit with the institutions of advanced market economies as we know them, i.e., the economic institutions that we find in developed liberal democracies. On the other hand, a philosophical model must articulate what is normatively attractive about these arrangements and would make it rational for people to adhere to their requirements.

The model of a complex institution fits with several important features of advanced market economies as we know them. The most obvious has to do with money. Focusing on the United States, a clearly articulated feature of the legal mandate of the US Federal Reserve System is price stability—i.e., 2% inflation.[14] To maintain this inflation target, the Federal Reserve must constantly adjust the supply of money in the economy to facilitate market exchange and thereby draw everyone into an efficient pattern of production and consumption. But it must carefully calibrate changes in the money supply so as to preserve the conditions in which market actors can make effective long-term plans (i.e., price stability). Economic efficiency is, in this way, an organizing principle built into the public system of reasoning that guides the 19,000 or so people working in the Federal Reserve System. As individual consumers, we may not think much about the money that we use to make purchases, but *the presence of money in our hands is no accident*: the supply of money is constantly being monitored and controlled, in part, to realize the aim of economic efficiency.

Another way that the model fits with advanced market economies as we know them has to do with the law. In most liberal democracies today, economic efficiency is an organizing principle that guides judges and lawmakers in developing, interpreting, and applying the various rules of a market economy. For example, antitrust law in the United States and competition law in Europe both set out some of the most important rules in advanced market economies. These bodies of law require individuals and firms to act in a mutually disinterested fashion, thereby creating the conditions for a competitive process that can generate "market clearing" prices (see Whish and Bailey 2018; Motta 2004). Legal prohibitions on "restraint of trade," "collusion," and "distortion of competition" all target activities that would otherwise prevent mutual adjustment in the market from drawing everyone into an economically efficient pattern of production and consumption. Economic efficiency

[14] The other objective is "maximum employment." See https://www.federalreserve.gov/faqs/what-economic-goals-does-federal-reserve-seek-to-achieve-through-monetary-policy.htm.

is, in this way, an organizing principle in a large body of jurisprudence that guides judges and other officials as they interpret and apply market rules.

Economic efficiency plays a similar role in many other aspects of the law, including corporate law, employment law, and patent law. For example, the provisions for bankruptcy in the United States are informed by considerations of economic efficiency, especially the importance of ensuring that productive assets will eventually be drawn into their most socially beneficial uses. Efficiency is also central in elaborating the rules that define the publicly traded business corporation and the default pattern for corporate governance, the rules for severance, the scope of patent protections, and much, much more.

Turning from fit to justification, the model of a complex institution, oriented toward maintaining an efficient pattern of economic activity in society, provides an attractive account of at least the basic normative appeal of advanced market economies as we know them.[15] According to the model, in a well-functioning market economy, production activity and consumption activity constantly adjust to new circumstances so as to maintain an efficient pattern. When a new technology emerges in society, production activity and consumption activity will evolve in ways that take advantage of the new technology to put citizens in a better position to realize their aspirations. Similarly, when the aspirations of citizens change, production activity and consumption activity will adjust to the new circumstances, reorienting production away from less desired goods and toward the goods that citizens need to realize their goals. An institution that has these properties is a desirable one, particularly given that no other feasible arrangement could reasonably be expected to achieve the same results.

A related consideration has to do with public recognition. Following Rawls (2001, 137), I take it that a large and complex institution would not realize certain valuable aims unless these aims were publicly recognized, i.e., unless these aims were incorporated into a public system of reasoning that guides officials in exercising their institutional powers. We know, e.g., that

[15] People often think of the legal powers of private ownership and exchange in a market economy as being justified on the grounds of liberal freedom. But as I argued in chapter 2, this rationale cannot provide a justification for the main elements of an advanced market economy because many important forms of ownership in these arrangements—e.g., ownership of offshore natural gas deposits—really bear no significant relation to the liberal ideal. These and many other features of a market arrangement are better understood in terms of the need for social coordination, i.e., for organizing citizens to produce things and consume things in a certain way.

competition between firms in an advanced market economy may lead to a situation in which one or a few firms dominate a sector and use their market power in ways that prevent market coordination from generating an efficient pattern (Motta 2004, 70–89). It follows that a market economy would not maintain an efficient pattern of economic activity over the long run unless some public commitment to efficiency directed public officials to break up excessive concentrations of economic power when necessary. Given that economic efficiency is a valuable aim, the model of a complex institution that is publicly committed to efficiency is more attractive than a simpler model that lacks such a commitment.

For the reasons of fit and justification considered, the correct model for advanced market economies as we know them is the model of a complex institution whose public justifying rationale is economic efficiency. An arrangement of this kind is constituted *both* by a structure of mutual adjustment that tends to draw people into an economically efficient pattern of production and consumption *and* by a public understanding that the arrangement is justified insofar as it realizes the aims of efficiency. Simpler models, such as a model based simply on Lockean property rights, do not fit with important features of our economic order (e.g., monetary policy driven by the aim of efficiency) and do not justify central features of this order (e.g., the power to form business corporations).[16]

Given that an advanced market economy is a complex institution of the kind that I described, it is no mere accident or unintended side effect that the structure of mutual adjustment in liberal democracies tends to maintain an efficient pattern of production activity and consumption activity. In most liberal democracies today, economic efficiency permeates a vast social enterprise that manages market interaction: from officials in the US Federal Reserve constantly adjusting the money supply, to legislators, judges, and civil servants defining and redefining the rules of ownership, exchange, competition, bankruptcy, etc., economic efficiency is a pervasive public aim that guides officials in managing the market process and guides them in interpreting and developing market rules.

Let me elaborate on two points about the model. First, most individual consumers and producers in an advanced market economy do not desire,

[16] For an excellent discussion showing how the power to form a business corporation cannot be understood in terms of Lockean property rights, see Ciepley (2013).

value, or intend to bring about efficient patterns of production and consumption; they simply exercise their market powers for the sake of securing benefits for themselves. The model of a complex institution accepts that market coordination is an equilibrium process of the kind that Nozick describes (see section 3.4). What the model stresses is that in an advanced market economy, there is an enormous institutional apparatus whose purpose is to manage the conditions of the equilibrium process so as to ensure that it continuously draws market actors into an efficient pattern of production and consumption. If we see a society-wide pattern of production and consumption that is economically efficient in our society, this is *not* the product of an intentional effort by *market actors themselves* to organize their activities this way. But the overall tendency of market coordination to draw these actors into an efficient pattern is at least in part the product of an intentional effort—i.e., the effort of a vast army of public officials who monitor the market coordination process and adjust its rules over time.

Second, economic efficiency may play a role in the public system of reasoning that guides officials in an advanced market economy, even if most members of the community do not value economic efficiency as private persons. For instance, the official aims of the US Federal Reserve are set out in the law. Particular individuals may come and go from the various offices defined by the Federal Reserve System, but whoever happens to hold these offices will find that certain statutory aims are supposed to guide her decisions. Monetary policy in the United States may aim at facilitating the process of mutual adjustment in the market and generating an efficient pattern of production and consumption, even if individual members of the community do not themselves value economic efficiency when they are acting outside of any official capacity.

Many people think of the economic institutions in developed liberal democracies as simple private property schemes, not unlike the Lockean arrangement I considered. But thinking of our economic institutions in this way masks something fundamental about them. A simple private property scheme may provide people only with certain basic rights, but an advanced market economy is supposed to do more. The public justifying rationale of the arrangement is not simply to provide people with certain rights or certain options; it is to draw them into certain *patterns of activity*. The economic order that we live in is a mechanism of social control, and this fact is essential to understanding its moral nature.

3.11. Summing Up and Looking Ahead

It's now time pull together the various threads of this chapter. At the most fundamental level, an advanced market economy is a coordination mechanism, a way of getting ourselves organized to produce things and consume things in a certain way. When I go to the grocery store, I adhere to the requirements of private ownership, exchange, and mutual disinterest, as do the other people in the store. The store itself is part of a wider domain based on the same requirements. When everyone adheres to these requirements, we create a system of evolving option sets that draw everyone in society into a pattern of production activity and consumption activity that is economically efficient. And the arrangement is publicly understood to be justified insofar as it maintains an efficient pattern of this kind.

Mutual adjustment in the market draws citizens into certain patterns of activity through a process that bypasses our judgments about these patterns. In the next chapter, I will develop a theory about the moral justification of coordination mechanisms that work this way. Appealing to an ideal at the heart of Kant's moral philosophy, I argue that judgment-bypassing coordination mechanisms suffer from a potential moral defect—i.e., authoritarianism. These arrangements are structured in such a way that they may be inconsistent with citizens respecting themselves and one another as free persons, each entitled to guide her activities in light of her own practical judgments.

4
Authoritarianism in a Coordination Mechanism

An advanced market economy is a coordination mechanism, a way of getting ourselves organized to produce and consume things in a certain way. The arrangement defines a structure of mutual adjustment, which constantly draws us into a society-wide pattern of production activity and consumption activity that is economically efficient. Maintaining an efficient pattern is the central public justifying rationale for the enterprise, an organizing principle that guides public officials in exercising their powers to manage the institution and to develop its rules over time. I showed in the previous chapter how an advanced market economy draws us into an efficient pattern through an external process that bypasses our private judgments about the pattern. In this chapter and the next, I develop an account of a potential moral defect in coordination mechanisms that operate in this way.

A social coordination mechanism must be consistent with mutual respect among citizens: its rules must be consistent with our respecting ourselves and one another as free persons, each entitled to govern ourselves in light of our own practical judgments. But coordination mechanisms that draw people into certain patterns through a process that bypasses their private judgments about these patterns suffer from a potential moral defect. Like a government that makes laws without regard for public opinion, these arrangements may be "authoritarian," determining our conduct in a way that embodies a lack of respect for ourselves and one another as free persons. Importantly, there are certain circumstances in which judgment-bypassing coordination mechanisms are consistent with mutual respect—at least when coupled with the right mitigating features. But outside of these circumstances, these arrangements are morally defective.

In this chapter, I will develop a basic account of the potential moral defect in judgment-bypassing coordination mechanisms. In chapter 5, I fill out the view by laying out the special circumstances in which judgment-bypassing coordination mechanisms may be consistent with mutual respect. Together,

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the two chapters explain when a social coordination mechanism exhibits the moral defect of authoritarianism.

4.1. From the Moral Point of View, Institutions Are Practical Proposals for How Citizens Should Think and Act

In order to situate the discussion, I begin with a few background ideas about the morality of social institutions and the morality of individual conduct. These ideas spell out more precisely what I mean by a "moral defect" in a social institution and how the defects of this kind figure into the assessment of institutions and individual conduct.

Recall that a social institution is a shared understanding among the members of a community about how people are supposed to think and act in certain circumstances, where each member has an obligation to adhere to the shared understanding in part because the others are adhering to it as well (see chapter 1). In the case of a parking lot, drivers typically share an understanding about where people may park their cars and who has the right of way, and part of the reason each driver has an obligation to adhere to the shared understanding is the fact that the other drivers are adhering to it as well.

When we assess institutions from the practical standpoint, we assess them in the first instance as potential schemes that could serve as the content of a shared understanding in a community. When you observe a game of volleyball, e.g., the game is a pattern of behavior in the world, guided by a shared understanding among the players about what the game requires. But when you and your friends are at the beach trying to *decide* what to do for the afternoon, you look at the game as a practical proposal for how you and your friends should think and act. The game is a scheme of rules and organizing principles that you all could adopt as a coordinating structure for your activities. In coming to a decision about what to play, you assess volleyball and other games by asking how well these would serve in the role of a shared understanding that everyone has an obligation to adhere to in part because the others are adhering to it as well.

From the practical standpoint, institutions can be morally sound or morally defective, where moral soundness and defectiveness are objective properties of a scheme that count as powerful reasons for or against adopting it. Imagine, e.g., an institutional arrangement for distributing cake slices in a classroom, where the rules direct the teacher to give equal slices to each of the students, other things being equal. As a practical proposal, the equal slices arrangement treats students fairly and is—in this respect—morally sound. When students, teachers, principals, or anyone else considers possible schemes for organizing the classroom, the fact that the equal slices arrangement treats students fairly is an important consideration that counts in favor of the regime. Moreover, the fact that the arrangement treats students fairly is objective in the sense that the scheme treats students fairly, whether students, teachers, principals, or anyone else realizes that it does.

The moral soundness or defectiveness of an institution has important implications for various moral judgments that we make about individuals. I will illustrate a few key points using the familiar case of social justice. When members of a community adhere to the requirements of a social institution, they all take part in the moral soundness or defectiveness of the arrangement. On Rawls's view, e.g., the basic structure of society is unjust when (among other things) it does not conform to the difference principle. If we live in a society whose basic institutions do not conform to the difference principle, then our institutional order is unjust and therefore morally defective. It is also a fact about us that we are all involved in an unjust enterprise: the injustice of the institution is a fact about what we are doing, a fact about the shared activity we are all involved in.

Importantly, the moral soundness or defectiveness of a social institution does not provide a basis for directly assessing our conduct as individuals. The soundness or defectiveness of the institution plays a role instead in determining our duties as individuals, and it is *these duties* that form the basis for assessing our conduct as individuals. For example, if our basic institutions violate the difference principle, then our social order is unjust and we are all involved in an unjust enterprise. In the context of an unjust social order, citizens have various duties, such as a duty to vote for change, to campaign for reform, to run for office, to engage in civil disobedience, etc. Whether our conduct as individuals is moral or immoral depends on whether we live up to these civic responsibilities.

A related feature of political morality has to do with moral praise and blame (see especially Scanlon 2008). When an institution is unjust, many individuals may not be aware of this fact. But the epistemic condition of individuals does not bear on the moral soundness or defectiveness of the institution itself or on the content of individual duties. These facts bear instead on the assessment of the character of individuals and their blameworthiness for any wrongful conduct. Suppose that the basic structure of society violates the difference principle because of some complex feature of the tax code. If I am not aware of this feature of the tax code, then I may not be aware of the injustice or of my duty to vote against the current scheme. These facts about my epistemic condition do not bear on the moral soundness of the institutional order or the content of my duties; they bear rather on whether I am blameworthy for not living up to my duties. If someone comes along and explains the relevant facts about the tax code, then I will come to see that the current regime was always unjust and that I always had a duty to do something about it: the explanation makes me aware of reasons that I already have—it does not create any new reasons.

No doubt there is more to say about these issues, but my aim here is only to set out a few key ideas that will inform the discussion in this chapter and the next. In what follows, I will develop an account of a particular moral defect that a social institution can exhibit. The defect is similar to injustice in that it is an objective feature of an institution that counts as a powerful reason not to adopt the scheme. The defect forms the basis for a range of duties on individual citizens to resist, reform, or dismantle an institution if it exhibits the defect. Individual states of knowledge and understanding bear on whether people are blameworthy if they fail to live up to their civic duties, but these states do not bear on the fundamental defectiveness of an institution itself or on the content of these duties.

The defect I will focus on is one that we find in certain social coordination mechanisms. Call this defect *authoritarianism*. An authoritarian coordination mechanism is like an authoritarian government in that it maintains a certain pattern of activity, but does so in a way that is not properly sensitive to the independent judgment of citizens. In order to develop the idea, I begin with a more intuitive case, i.e., a coordination mechanism that maintains a certain pattern by means of an authority structure.

4.2. Some Coordination Mechanisms Maintain a Certain Pattern of Activity by Defining an Authority Structure

One way for a social coordination mechanism to generate and maintain a certain pattern in people's activities is by means of an *authority structure*. A coordination mechanism defines an authority structure when it has two features.

First, the arrangement requires individuals to treat a certain set of rules S as authoritative. This means that individuals must treat the fact that some action conforms with S both as a reason for performing the action and as a reason not to act on the underlying (rule-independent) considerations that count for or against the relevant action (Raz 1979a, 1990; see also Hart [1982] 1990). In Joseph Raz's terminology, the institution requires participants to treat conformity with the rules both as a reason for performing an action and as an "exclusionary reason" not to act on the basis of the considerations that might otherwise tell for or against that action. In effect, the rules are supposed to displace certain underlying considerations in the practical reasoning of members.

Second, a coordination mechanism defines an authority structure when the arrangement defines the set of authoritative rules S in terms of a certain set of criteria (Hart 1997). Among the relevant criteria might be the fact that a rule is mentioned in some text, the fact that a rule is endorsed by some official, or the fact that the rule was enacted through some procedure. The institution requires participants to treat whatever rules satisfy the relevant criteria as belonging to the set of rules S that participants must treat as authoritative.

A military hierarchy is an example of an authority structure. In an arrangement of this kind, soldiers must treat a certain body of rules—e.g., "Wake up at 6 a.m.," "Lights out by 9 p.m."—as authoritative. Soldiers must treat the rules both as reasons for performing certain actions and as reasons not to act on the underlying considerations that count for or against these actions. For instance, if a soldier could complete an important task at 10 p.m., the authority structure requires her not to act on this fact and simply to follow the 9 p.m. rule instead. The hierarchy defines the body of authoritative rules in terms of certain criteria, the most important of which is that a rule has been endorsed by the right commanding officer. When everyone adheres to the requirements of the scheme, soldiers will comply with a certain body of rules, regardless of whether they believe the relevant actions are independently justified, and commanding officers will be in a position to generate certain patterns of activity by making and changing the authoritative rules.

As I noted, the public justifying rationale for a social coordination mechanism is to maintain a certain pattern of activity. An authority structure is one way for a coordination mechanism to realize the aim. In the case of a traffic system, e.g., the public justifying rationale for the arrangement is to maintain a safe pattern of driving activity on the roads. In order to draw citizens into a safe pattern, a traffic system could incorporate an authority structure. The arrangement would require drivers to treat a certain body of rules (i.e., a traffic code) as authoritative. At the same time, the arrangement would define an array of offices (i.e., a bureaucracy), where officeholders have the power to change the traffic code and a duty to use this power to draw people into a safe pattern of driving activity. When everyone adheres to the requirements of the scheme, drivers will defer to the official speed limits on roads and highways, and officials will ensure that these limits fall within the parameters of a safe driving pattern. By requiring drivers to treat the rules as authoritative and requiring the bureaucracy to enact the right rules, the authority structure can draw everyone into a safe pattern of driving activity.

4.3. A Coordination Mechanism That Relies on an Authority Structure Has a Potential Moral Defect

A social coordination mechanism that incorporates an authority structure defines a particular kind of social enterprise. If we were thinking about adopting the mechanism for our society, we might say that it involves "the determination of individual conduct through a judgment-bypassing process." Consider that the authority structure is a way of putting the set of rules S in a position where these rules direct the activities of individuals. Putting these rules in a position to do this requires bypassing (at least in part) the practical judgments of individuals that would otherwise determine their conduct. So when members of a community adhere to the requirements of the authority structure, they each take part in an enterprise that determines the conduct of individuals through a process that bypasses the private judgments of individuals about their conduct.

We can think of the activity as having two aspects. On the one hand, when members of a community adhere to the requirements of the scheme, they *partially surrender the direction of their own conduct to something external to their practical judgments*. In the case of a traffic system, members will not guide their activities in light of their own judgments about what courses of action are favored by the balance of underlying considerations. Instead, they will follow the body of authoritative rules—i.e., the traffic code—and allow these rules to displace their own assessments of the underlying considerations.[1]

[1] By extension, since there is a certain procedure that determines the content of the rules, members also surrender the direction of their conduct to the procedure—i.e., the bureaucratic process—that makes and changes the rules over time.

On the other hand, when members of a community adhere to the requirements of the scheme, they participate in *partially bypassing one another's judgments to determine one another's conduct.* In the traffic case, some members of the community will occupy offices in the bureaucracy and use their official powers to make authoritative rules that partially bypass the practical judgments of drivers to determine their conduct. Other members of the community will provide logistical support to the rule makers—doing the research that prepares the way for the rules, writing the rules, publishing the rules, etc. And in addition, members generally will socially reinforce the authority structure by criticizing and sanctioning those who fail to live up to its requirements; e.g., members will criticize drivers for failing to conform to the traffic code or for conforming only when the rules mirror their own independent judgments.

In virtue of the features just considered, a social coordination mechanism that relies on an authority structure is potentially inconsistent with an important moral ideal. This is the *Kantian ideal of mutual respect*. As applied to an institution, the Kantian ideal requires that the institution should be structured in such a way that its requirements are consistent with individuals respecting themselves and one another as free persons, each entitled to guide her activities in light of her own practical judgments. When a social coordination mechanism incorporates an authority structure, it is structured to determine individual conduct through a judgment-bypassing process. As such, it is—at least potentially—inconsistent with the Kantian ideal.[2]

On the one hand, the coordination mechanism is structured in such a way that when members adhere to its requirements, *they do not respect themselves as free persons*. Instead of guiding their activities in light of their own practical judgments about the underlying considerations, members partially surrender the guidance of their activities to a body of rules that displaces their practical judgments. Instead of treating themselves as free persons, entitled to act in light of their own practical judgments, members treat themselves as having the status of beings who may be properly subordinated to something outside of their own practical judgments.

On the other hand, the coordination mechanism is structured in such a way that when members adhere to its requirements, *they do not respect one another as free persons*. Members take part in an enterprise in which they

[2] In chapter 5, I will lay out the circumstances in which an arrangement that is *prima facie* inconsistent with the ideal is actually consistent with it.

determine one another's conduct through authoritative rules that partially bypass one another's practical judgments; they do this by making use of rule-making powers, providing logistical support to the rule makers, and by socially reinforcing the judgment-bypassing character of the rules. Instead of treating one another as free persons, each entitled to act on her own practical judgments, members treat one another as having the status of beings who may be subordinated to something outside of their own practical judgments.

4.4. The Potential Moral Defect Has Nothing to Do with Relations of Personal Obedience and Subordination

I want to clarify something about the nature of the potential moral defect in social coordination mechanisms that rely on authority structures. Many philosophers conceive of authority as a *personal* relation between two or more agents. On this view, a person A stands in an authority relation with a person B when B has the right to command A and the right to be obeyed by A (see Wolff 1976). Essential to authority relations, so understood, is that they involve the subordination of one person to the will of another person: A stands in an authority relation with B when A is required to do what B tells her to do simply because B—this particular person—tells her to do it.

The model of personal obedience may be appropriate for thinking about authority relations in certain kinds of cases—e.g., the authority of parents over their children. But it is not appropriate for thinking about authority relations in an authority structure. This is because the central authority relation in an authority structure is *impersonal*: it holds between individuals and a body of authoritative rules picked out by a rule-specifying procedure or standard. The relation involves subordination to an impersonal set of rules and procedures, not personal obedience to an individual person. In the case of a military hierarchy, soldiers stand in an authority relation with the body of authoritative rules that are picked out by a rule-specifying procedure (i.e., the chain of command). With respect to this body of rules, the authority structure requires soldiers to comply with the rules simply because these are the rules, setting aside their own assessment of the rule-independent considerations that bear on the relevant actions.

When an authority structure defines a procedure that picks out authoritative rules, the procedure may define offices that have rule-making powers attached. For instance, the military chain of command will define offices for "sergeants," "majors, "generals," etc., along with priority rules that determine how decisions by each officeholder interact with those of the others to determine the content of the rules. But it is essential to see that the existence of an office does not create a relation of *personal* deference or obedience to the officeholder. The person who happens to hold the office with the rule-making power attached does not have a personal power to command others, and others do not owe deference to her as an individual. What the scheme requires is that individuals treat a certain body of rules as authoritative, and the power of the officeholder stems purely from the position that the office occupies in a system of criteria that determine what the rules are.

To make the impersonal character of authority in this context more vivid, imagine an authority structure that defines a complex rule-making process that involves several independent bodies, where officeholders in each body have voting powers and authoritative rules are picked out by some complex formula that involves votes taken in each body. For example, laws in the United States are rules that have been selected through a process that involves majoritarian voting among 435 representatives in the House, majoritarian voting among 100 senators in the Senate, the veto power of the president, the power to override a presidential veto by a supermajority in both houses of Congress, and oversight by the nine members of the US Supreme Court (subject to majority rule among the justices). In an authority structure with a complex rule-making procedure of this kind, the authoritative rules may represent a series of compromises between various officeholders and various constituencies, where many of the officeholders do not personally agree with the rules that result from the process. It may even turn out that the rules represent the first preference of *none* of the individuals who hold offices in the rule-making process (see Dahl 2006; Pettit 2001). The officeholders are like cogs in a complex machine: although the officeholders take part in the process, the rule-making process *itself* determines how the disparate actions of officeholders come together to affect the authoritative rules. The mediation of the process means that the officeholders do not stand in anything like a personal authority relation with the individuals who are ultimately subject to the rules.

The point extends to political government more generally. Some philosophers conceive of political government on the model of a personal authority relation. On this view, the "state is a group of persons who have and exercise supreme authority within a given territory" (Wolff 1976, 1). Laws are understood as the exercise by this group of a collective right to command those who live in the territory and a collective right to be obeyed by these people. It follows that citizens in a political community find themselves in a normative situation where they must obey certain rules simply because a particular group of persons—i.e., the state—tells them to do so.

As H. L. A. Hart ([1982] 1990, 105–6) rightly notes, this personal view of authority is highly misleading as a way of thinking about modern political systems:

> [I]n the history of legal theory it has often been pointed out that, except in very simple societies, a simple command is an inappropriate model for legislation since, except in those societies, a definite law-making procedure must be complied with if the legislator's words or deeds are to make law. . . . For this reason the enactment of a law is very unlike a simple command or expression by an individual of his wishes or intentions as to other persons' conduct, and the habit of speaking of the Sovereign as if he were a single individual is unfortunate just because it may encourage too close an assimilation of law-making to the giving of a command and conceal the need and importance of a recognized procedure. . . . Given such a procedure which may include the voting and counting of votes, the reading of a bill, the issue of certificates, etc., law is created by compliance with [the procedure] and the analogy of a simple command or order expressing the will of an individual is misleading.

Hart correctly emphasizes here that what generates the laws in a political community is a certain *lawmaking procedure*, not the commands of particular individuals. Because of the complex nature of lawmaking procedures in contemporary societies, and the way that they involve multiple actors and multiple bodies, the law is not properly understood as the product of any individual or group of individuals but rather of a complex lawmaking procedure that determines how everyone's actions combine to determine the content of the law. Hart goes on to stress that authoritative legal rules in many cases are not the product of any kind of *legislative act* at all; they may derive from customary practices that are recognized by the courts as having the force of law or by legal precedent or by some other facts that are not actions. In the latter case, it is particularly clear that the authority relation in a modern political community is impersonal and involves subordination to rules rather than particular persons.

I draw attention to the impersonal nature of the authority relation in an authority structure to emphasize something about the potential moral defect in coordination mechanisms that rely on these structures. The potential moral defect has nothing to do with relations of personal deference or obedience to individual agents—e.g., kings, legislators, bureaucrats, judges. The potential moral defect is impersonal: it has to do with a *judgment-bypassing form of social control.* When members of a community adhere to the requirements of a coordination mechanism that relies on an authority structure, they each take part in the determination of individual conduct through a judgment-bypassing process. On the one hand, they surrender the direction of their own conduct to a body of authoritative rules picked out by a certain procedure. On the other hand, they take part in the determination of one another's conduct by a body of judgment-displacing rules and procedures. In virtue of these features, a coordination mechanism that relies on an authority structure is potentially inconsistent with the Kantian ideal of mutual respect. Whether the coordination mechanism also involves some form of personal obedience or subservience is beside the point.

4.5. A Coordination Mechanism That Relies on a Structure of Mutual Adjustment Also Determines People's Conduct through a Judgment-Bypassing Process

A coordination mechanism that draws people into a certain pattern of activity by means of an authority structure has a potential moral defect. The defect stems from the fact that the arrangement involves the determination of individual conduct through a judgment-bypassing process. I want to show now that another kind of coordination mechanism shares the same problematic feature.

Recall a concept from chapter 3. A structure of mutual adjustment is an institution whose requirements are structured so that the choices that each participant makes from within her option set help to define the option sets open to the other participants in an iterative process. As each participant makes a choice from within her option set, this changes the option sets open to some of the others. Participants with changed option sets then make choices that lead to further changes in people's option sets and further choices. The process continues in this way, and under certain conditions it will come to rest when the participants have been drawn into a certain overall pattern of activity. The pattern that results cannot be attributed simply, however, to the private choices of participants. This is because the pattern that results is substantially the product of the process that constantly shapes everyone's option sets in such a way as to lead everyone into the pattern.

Consider now three different types of social coordination mechanisms. All three are complex institutions whose public rationale is (in part) to draw individuals into a certain pattern of activity R. Where they differ is in how they draw individuals into the pattern. Here are the three types:

> **Type I (authoritative rule):** The coordination mechanism requires members to treat a certain set of rules S as authoritative. One of the rules has the form "All members must R."

> **Type II (authoritative office):** The coordination mechanism requires members to treat a certain set of rules S as authoritative. The arrangement defines a set of offices, such that officeholders have the power to make and change the authoritative rules and a duty to exercise these powers in such a way as to draw everyone into the pattern R.

> **Type III (mutual adjustment):** The coordination mechanism defines a structure of mutual adjustment, such that when members conform to the requirements of the arrangement, they create a constantly changing array of option sets, and the changing array of option sets continuously draws everyone into the pattern R.

The key point is that all three types of coordination mechanisms draw individuals into a certain pattern R in a way that bypasses the private judgments of individuals about R. A Type I coordination mechanism requires individuals to treat a body of rules as authoritative, where these rules displace certain practical judgments that might otherwise direct individual conduct. One of the rules requires individuals to R, so when everyone adheres to the requirements of the scheme, the arrangement draws everyone into the pattern R in a way that bypasses their independent judgments about R. A Type II coordination mechanism is similar, except it introduces an office with a duty to enact a rule of the form "All members must R."

A Type III coordination mechanism differs from those of Types I and II because it has no authoritative rule of the form "All members must R" and no office with the duty to make such a rule. But a Type III arrangement still generates the pattern R through a judgment-bypassing process. As members adhere to the requirements of the scheme, they create a system of constantly changing option sets. Each person's option set evolves in such a way as to draw her into the pattern R, and it does so in a way that bypasses her private judgments about the pattern.

The preceding definitions are somewhat abstract, but an illustration will help to make the ideas more concrete. Consider the following three examples:

Gym I (authoritative rule). You are a student in a high school gym class. Young people your age need to run about the length of the soccer field each class in order to stay healthy. To ensure that you and your classmates get the right amount of exercise, the institutional order in your school requires everyone to treat a certain body of rules S as authoritative, where the following is one of the rules: "Students must run the length of the soccer field each gym class."

Gym II (authoritative office). You are a student in a high school gym class. Young people your age need to run about the length of the soccer field each class in order to stay healthy. To ensure that you and your classmates get the right amount of exercise, the institutional order in your school requires students to treat a certain body of rules S as authoritative. The order creates the office of "gym teacher," where the person holding this office can change the authoritative rules and has a duty to ensure that everyone gets the right amount of exercise.

Gym III (mutual adjustment). You are a student in a high school gym class. Young people your age need to run about the length of the soccer field each class in order to stay healthy. It turns out that young people your age playing a decently competitive soccer match will run about the length of the soccer field over the course of a class period. To ensure that you and you classmates get the right amount of exercise, the institutional order in your school incorporates a soccer match into every gym class, where the winners get a higher grade and the losers get a lower grade.

Gym I, II, and III describe scenarios in which the members of a small-scale community (i.e., a school) adhere to the requirements of three different coordination mechanisms. The mechanisms in each case have the same public justifying rationale, which is to maintain a certain pattern of healthy activity among the students. Where the three mechanisms differ is in how they bypass the private judgments of students to maintain the pattern.

In Gym I, the judgment-bypassing form of social control is out in the open. If you are a student in gym class, you can see an explicit rule that says that everyone must run the length of the field each class, and everyone knows that students must comply independently of their private judgments about the pattern. If you don't comply with the rule, the other members of the community will criticize and sanction you; e.g., the other students might remind you of the rule; the gym teacher might yell at you; and eventually you might end up in detention. The rule makes it clear to everyone that they are all involved in an enterprise that maintains a certain pattern of activity in a way that bypasses the private judgments of individuals about the pattern.

Much the same holds in Gym II. If you are a student in gym class, there is an authority figure—i.e., the gym teacher—who is in a position to make authoritative rules in gym class. Everyone can see the gym teacher and understands her rule-making powers. When the teacher makes a rule that requires everyone to run the length of the field, everyone knows that students must comply independently of their own private judgments about the pattern. If you don't comply with the rule, the other members of the community will criticize and sanction you: the other students might remind you of the gym teacher's position in the school hierarchy; the gym teacher might yell at you; and eventually you might end up in detention. Here both the office and the rule make it clear to everyone that they are all involved in an enterprise that maintains a certain pattern of activity in a way that bypasses the private judgments of individuals about the pattern.

In Gym III, however, the judgment-bypassing form of social control is not out in the open in the same way. If you are a student in gym class, there is no explicit rule that says that everyone has to run the length of the field and no authority figure who adopts such a rule. If you don't run the length of the field, no one is going to criticize you or sanction you for not doing so. *All you see is a game*. Your option set in the game is constantly changing, and it evolves in such a way as to draw you into a certain pattern—i.e., running the length of the field over the course of the class. As we saw in chapter 3, any time you act in a way that is inconsistent with the overall pattern (e.g., standing around doing nothing), your option set changes in such a way as to get you back into the pattern. Here there is no explicit rule or authority figure to make clear to everyone that the community as a whole is involved in an enterprise that maintains a certain pattern of activity in a way that bypasses the private judgments of individuals about the pattern.

Note that I am not arguing here that students in Gym III stand in an authority relation with the soccer game or with the process that constantly changes their option sets in the game. The judgment-bypassing form of social control in Gym III is different from what we see in the other two cases. For example, if we compare Gym II and Gym III, there are two important differences:

(a) there is a personified authority figure in Gym II, but no such figure in Gym III;
(b) there is an authoritative rule of the form "All members must R" in Gym II, but no such rule in Gym III.

The second difference is important. The judgment-bypassing form of social control in Gym III is *nondiscursive*: the institution does not address individuals with a rule telling them to act consistently with the pattern R. The institution bypasses the need for an explicit rule by shaping and reshaping the choice contexts of individuals in such a way as to maintain the pattern R. So my point is not that there is a hidden authority structure in Gym III, but that judgment-bypassing forms of social control need not take the form of an authority structure, and Gym III illustrates this important fact.

4.6. A Coordination Mechanism That Relies on a Structure of Mutual Adjustment Has the Same Potential Moral Defect as One That Relies on an Authority Structure

A coordination mechanism that relies on a structure of mutual adjustment defines a particular kind of social enterprise. If we were thinking about adopting the mechanism for our society, we might say that the arrangement involves "the determination of individual conduct through a judgment-bypassing process." Consider that a structure of mutual adjustment is a way of drawing members into a certain pattern of activity, where the pattern emerges independently of the practical judgments of individuals about the pattern. So when members of a community adhere to the requirements of the structure, they each take part in an enterprise that determines the conduct of individuals through a process that bypasses the private judgments of individuals about their conduct.

We can think of the enterprise as having two aspects. On the one hand, when members of the school community adhere to the requirements of the Gym III arrangement, they *partially surrender the direction of their own conduct to something outside of their practical judgments.* The changing option sets that students face on the soccer field will eventually draw all of them into a certain pattern of activity. But the pattern that results cannot be attributed simply to the sum of the private choices that students make from within their option sets. The pattern is substantially the result of the process that alters their option sets in such a way as to generate the pattern. So in adhering to the rules of the game, students in gym class allow an external process—the dynamic tendency of the game—to maintain a certain pattern in their activities, independent of their own practical judgments about the pattern.

On the other hand, when members of a community adhere to the requirements of the Gym III arrangement, they participate in *partially bypassing one another's judgments to determine one another's conduct*. In particular, students are prepared to socially reinforce the rules of the game by drawing attention to the rules, criticizing those who break the rules, and imposing sanctions on those who don't comply. By socially reinforcing the rules in this way, students maintain a structure that bypasses one another's private judgments to generate the pattern.

In virtue of the features just considered, a coordination mechanism that relies on a structure of mutual adjustment is potentially inconsistent with the Kantian ideal of mutual respect. On the one hand, the coordination mechanism is structured in such a way that when members adhere to its requirements, *they do not respect themselves as free persons*. Members partly surrender the guidance of their activities to a structure of mutual adjustment that draws them into certain patterns, independently of their private judgments about these patterns. So instead of treating themselves as free persons, entitled to act in light of their own practical judgments, members treat themselves as having the status of beings who may be properly subordinated to something outside of their own practical judgments.

On the other hand, the institution is structured in such a way that when members adhere to its requirements, *they do not respect one another as free persons*. Members take part in determining one another's conduct through a process that bypasses one another's judgments to determine one another's conduct. They do this mainly by socially reinforcing the rules of the mutual adjustment structure, i.e., citing the rules, criticizing rule-breakers, and imposing sanctions for noncompliance. Instead of treating one another as free persons, entitled to act on their own practical judgments, members treat one another as having the status of beings who may be subordinated to something outside of their own practical judgments.

4.7. A Basic Account of the Potential Moral Defect

We now have a basic account of the potential moral defect in a social institution that I am calling "authoritarianism." Some social coordination mechanisms maintain a certain pattern in individual conduct by means of a judgment-bypassing form of social control: e.g., mechanisms that incorporate an authority structure and mechanisms that incorporate a structure of mutual adjustment. In adhering to the requirements of these arrangements, members of a community potentially fail to respect themselves and one another as free persons each entitled to guide their conduct in light of their own practical judgments. As such, these arrangements are potentially inconsistent with the Kantian ideal of mutual respect and so potentially authoritarian.

The defect in these social coordination mechanisms is only potential, however, because there are certain cases in which judgment-bypassing forms of social control are consistent with the Kantian ideal of mutual respect. In the next chapter I will explain when these forms of social control are consistent with the ideal.

5

Reason Sensitivity, Transparency, and Trustworthiness

A social coordination mechanism that determines individual conduct through a judgment-bypassing process has a potential moral defect. The defect is potential because there are some circumstances in which a coordination mechanism of this kind may be consistent with the Kantian ideal of mutual respect. In the first three sections of this chapter, I will lay out the special circumstances in which these mechanisms are consistent with the Kantian ideal. The argument will rely on a parallel between the moral requirements that apply to a coordination mechanism and those that apply when one citizen attempts to shape the behavior of another. The final section will draw the arguments of chapters 3 and 4 together in a summary view of how to think about authoritarianism as a distinctive moral defect in a social coordination mechanism.

5.1. Under Certain Conditions, a Coordination Mechanism That Uses a Judgment-Bypassing Process May Be Consistent with Mutual Respect among Citizens

The Kantian ideal of mutual respect requires that citizens act in such a way that they respect themselves and one another as having a fundamental claim to be free, i.e., to guide one's actions in light of one's own practical judgments.[1] In the context of personal interactions, the ideal applies in the first instance to maxims.

[1] See Kant ([1785] 1996, [1797] 1996). See also O'Neill 1985. The Kantian ideal, as I formulate it, draws on Kant's work, but it is not an attempt to interpret Kant's own views as expressed in his writings. Insofar as I accept a realistic view of reasons, my view resembles Scanlon's, but the anti-authoritarian ideal differs from Scanlon's account of freedom (see Scanlon 1988, 1998; Hussain 2013). My view most closely resembles Habermas's (1996) account of deliberative democracy.

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A maxim is a governing rationale for action that sets out the considerations that an agent treats as reasons for performing a certain action in a certain context. The rationale is general in that it would commit the agent to performing other actions that follow from the rationale in the current context and in other contexts (see O'Neill 1985). For example, a maxim may involve my taking the fact that I need milk for my coffee tomorrow morning as a reason to go to the store. The maxim describes a rationale that would govern my ongoing actions in this context (e.g., making sure that I get to the store in time for tomorrow's coffee) and govern my actions in other contexts (e.g., going to a different store if the closest one is closed).

Maxims are morally sound or morally defective depending on whether they pass the following test: Could the maxim win the assent of all citizens as a law that determines how all citizens think and act, assuming citizens are all properly motivated by a concern for their freedom? In the case of going to the store, we must imagine a law of reasoning such that all citizens would treat the fact that they need milk for their coffee tomorrow morning as a reason for going to the store. If a community of citizens who care about their own freedom could assent to this as a law of reasoning for the members of the community, then the maxim is morally sound. If not, it is morally defective. The permissibility of actions then follows from the moral soundness or defectiveness of the maxims that might lead agents to perform these actions.

Consider now three different ways that one citizen A could try to get another citizen B to do something that A wants B to do. To make the issue more concrete, suppose that a giant snowstorm hits our town and I am having trouble clearing my driveway. You live next door and I would like your help. Here are three ways that I could get you to help me:

1. *Communicating a piece of relevant information*. One possibility is for me to say to you, "I am struggling with the snow; if you help me shovel my driveway, that would really make things easier." The maxim here is such that a citizen A treats the fact that communicating some piece of information to citizen B would draw B into a pattern that A wants B to engage in as a reason for A to communicate this piece of information to B. Providing the relevant piece of information would shape B's choice context and draw her into the desired pattern of activity, but it would not prevent B from acting on her own reflective appreciation of the underlying facts. Since the maxim does not involve obstructing or disabling anyone's capacity to guide her activity in light of her practical

judgments, it could win the assent of all citizens as a law of reasoning, assuming everyone was properly motivated by a concern for their freedom.

2. *Coercion*. Another possibility is for me to say to you, "Help shovel my driveway or I will shoot you." The maxim here is such that a citizen A treats the fact that threatening B with severe costs for her not taking part in a certain pattern that A wants B to engage in would lead B to engage in that pattern as a reason for threatening B. Unlike the maxim in the first case, the maxim in this case *does* involve obstructing another person's capacity to guide her activity in light of her own assessment of the underlying, coercion-independent facts. This maxim could not win the assent of all citizen as a law of reasoning, assuming that everyone was properly motivated by a concern for their freedom.
3. *A lying promise*. A third possibility is for me to say to you, "If you help shovel my driveway, I will paint your garage." But suppose that I intend never to paint your garage, whether or not you shovel my driveway. The maxim here is such that a citizen A takes the fact that communicating a certain intention to B would make it reasonable for B to participate in a certain pattern that A wants B to participate in as a reason to communicate the relevant intention to her. But the maxim has an added feature. Since A does not actually have the intention that makes B's participation reasonable, the maxim involves creating a choice context for B that *disables* her rational capacities: the lying promise disconnects B from a centrally important fact, i.e., that A does not intend to fulfill her promise. The maxim under consideration would direct citizens to disable one another's practical judgment in order to draw them into certain patterns of activity. As such, it could not win the assent of all citizens as a law of reasoning, assuming that everyone was properly motivated by a concern for their freedom.

From Kant's well-known examples, we can see that one person's shaping another person's choice context as such is not inconsistent with mutual respect. What is inconsistent is exercising this power in certain ways. Coercion and lying promises are both inconsistent with mutual respect because the maxims involved direct people to draw others into certain patterns by obstructing or disabling their ability to act on the basis of their own practical judgments. Furthermore, the ideal of mutual respect would rule out maxims that direct people to draw *themselves* into certain patterns by obstructing or disabling their *own* ability to act on the basis of their practical judgments—e.g., by limiting or blocking their own access to relevant information.

With the basic ideal of mutual respect in mind, the important question for my purposes has to do with judgment-bypassing forms of social control. What does the Kantian ideal of mutual respect imply for maxims that involve one person drawing another person into a certain pattern of activity through a mechanism of this kind? Is an interaction of this kind ever consistent with the ideal?

No doubt there are many cases in which employing a judgment-bypassing form of social control is inconsistent with mutual respect. But I take it that there is at least one type of case in which this type of influence is consistent with the ideal. This is a case in which two citizens, A and B, are in a situation where B cannot guide her activities in light of her own assessments of the underlying facts (perhaps these are not visible to her), but A is in a position to guide B's activities in light of these facts on B's behalf. A can act in these cases as an *extension* of B's rational capacities, guiding her activities in light of the relevant facts in the ways that B would have reason to if she were in a better position to govern herself. The maxim involved is one that directs a citizen in the position of A to treat the fact that she can draw a citizen in the position of B into a rational pattern of activity by means of a judgment-bypassing form of social control as a reason to use this form of social control. A maxim of this kind could win the assent of all citizens as a law of reasoning, assuming that everyone was properly motivated by a concern for their freedom.

For a maxim of the relevant kind to win the assent of all citizens, however, it would have to incorporate further features which embody an appropriate regard for people's rational capacities. These conditions for acceptability effectively determine how individuals may properly exercise judgment-bypassing forms of social control over one another. For example, I take it that anyone who exercises a form of control along these lines would have to use it with the aim of drawing those who are subject to this form of control into patterns of activity that are appropriate in light of the considerations that apply to them—after all, this is what justifies the use of this form of control in the first place (compare Raz 1990).[2] I will discuss the relevant requirements below, in connection with a social coordination mechanism.

[2] Note that I am not making a claim here about the nature of practical authority. Raz (1990) holds that practical authority, when it is justified, is justified because it helps those subject to the authority to act on reasons that already apply to them. Some might object that practical authority can also change the reasons that people have—e.g., if the legislature passes a law requiring X, then citizens

5.2. To Be Consistent with Mutual Respect, a Coordination Mechanism That Uses a Judgment-Bypassing Form of Social Control Must Satisfy Three Requirements

Imagine that the members of a political community are looking to organize their activities in some domain. Suppose that it is not possible for citizens in a large and complex society to gather all of the relevant information, meet on a regular basis, deliberate, and consciously organize their activities in ways that are sensitive to the underlying practical considerations. Under these conditions, a coordination mechanism that determines individual conduct through a judgment-bypassing process may be able to draw citizens into a rationally attractive pattern of activity and maintain this pattern over time (see Hayek [1945] 1996; see also section 5.3). By doing their parts in the arrangement, citizens would maintain a certain pattern and would do so in a way that bypasses the private judgments of individuals about the pattern. But since citizens are not in a position to guide their conduct on their own in light of the relevant considerations, the coordination mechanism may operate as an extension of their rational capacities and may therefore be consistent with mutual respect. The coordination mechanism could win the assent of all citizens as a law of reasoning, assuming that they were all properly motivated by a concern for their freedom.

Much as in the case of maxims of interpersonal conduct, however, a coordination mechanism must incorporate certain features in order for this judgment-bypassing form of social control to be consistent with mutual respect. The mechanism must be designed not only to draw people into attractive patterns of activity but also to do so in a way that is properly respectful of their freedom, i.e., their capacity to direct their activities in light of their own practical judgments.

How does a coordination mechanism embody mutual respect understood in this way? On my view, it does so when it satisfies three requirements:

1. **Reason sensitivity:** A social coordination mechanism must be structured so that it draws citizens into a pattern of activity that is comprehensively reasonable, i.e., a pattern that belongs to the set of patterns

have a reason to X that they did not have before. I take no stand on this question about practical authority; my claim is narrowly about when judgment-bypassing forms of social control are justified.

that citizens have most reason to engage in, taking into account all relevant social values and ideals (including some notion of feasibility).

2. **Transparency:** To the extent that this is compatible with reason sensitivity, a social coordination mechanism must be structured so as to put citizens in a position to identify (at an appropriate level of generality) the pattern of activity that the mechanism is drawing them into and to assess whether this pattern is comprehensively reasonable.
3. **Trustworthiness:** A social coordination mechanism must be structured so as to put citizens in a position such that it would be reasonable for them to trust that the system is drawing them into patterns of activity that are comprehensively reasonable, even when the arrangement cannot put them in a position to make these determinations for themselves.

The first requirement is reason sensitivity. It says that a social coordination mechanism must be structured so as to draw citizens into a pattern of activity that is comprehensively reasonable, i.e., a pattern that is justified in light of the values and ideals that bear on the choice of a pattern. The design of the arrangement must take into account that there may be no one uniquely best pattern and that the justification of a pattern may depend on what is feasible given existing social conditions. When a coordination mechanism draws citizens into patterns of activity that are comprehensively reasonable, it serves the most basic justifying function of a judgment-bypassing form of social control, i.e., making up for the inability of citizens to guide their conduct on their own in light of the relevant considerations.

The next two requirements stem from the fact that drawing citizens into a comprehensively reasonable pattern of activity is not all that matters from the standpoint of mutual respect. After all, if a group of supremely intelligent bureaucratic officials could draw citizens into a comprehensively reasonable pattern of activity, mutual respect would still require these officials to address citizens and explain their decisions to them. It would be inconsistent with mutual respect for these officials to hide their efforts, to act in secret, or to deny citizens the opportunity to act with a full understanding of the reasons that justify their conduct.

Following from this observation, the transparency requirement says that a social coordination mechanism must put citizens in a position to appreciate the general features of the pattern of activity that it is drawing them into and the justification for this pattern. The transparency requirement is context-dependent and may require greater transparency when it comes to issues that are especially important to particular groups of citizens. If a coordination mechanism is drawing citizens into a pattern that will have a particularly significant impact on a certain subgroup, then it will have to put these citizens in a position to understand the relevant aspects of the pattern and its justification in greater detail.

The third requirement is trustworthiness. Reason sensitivity may sometimes require that a social coordination mechanism draw citizens into certain patterns of activity without immediately making the pattern or the reasons that justify the pattern available to those involved. The coordination mechanism may have to work at a level below the "conscious awareness" of the public. In these cases, mutual respect requires that a coordination mechanism put citizens in a position such that it would be reasonable for them to trust that the arrangement is drawing them into a pattern that is comprehensively reasonable and that the arrangement falls short of transparency only when necessary.[3]

5.3. An Illustration: Traffic Lights

I want to illustrate the three requirements by returning again to the case of a traffic system. This time, however, the system is slightly different because it is meant to represent the more general class of coordination mechanisms that rely on judgment-bypassing forms of social control. Here is the revised arrangement:

> **Traffic system (traffic lights).** You live in a large city with a traffic system. The public justifying rationale for the system is to draw residents into a safe pattern of driving activity. The system does not rely on a detailed traffic

[3] The trustworthiness requirement is something that we apply naturally in cases where institutions empower officials to act in ways that are not transparent to the public. When reason sensitivity does not allow for full transparency, institutions often require officeholders to adhere to procedures that provide the public with a reasonable basis for trusting these officials. When dealing with terrorism, e.g., coordinating the effort to protect the public may require that security officials gather information and deliberate in secret about what targets to pursue or what means to use against these targets. In the United States, FISA courts provide an external (but still secret) review of the legality of FBI and NSA decisions; the House and the Senate both have oversight committees with security clearances; and various sunset provisions allow for an examination of secret decisions in the fullness of time. The trustworthiness requirement simply extends the familiar requirement to all coordination mechanisms, even those that do not rely on personified officials.

code to realize this aim; instead, it relies on a network of traffic lights. The rules of the system require drivers to treat red lights and green lights as defining their option sets at every intersection. The lights are controlled by a software program that "opens" and "closes" doors for all the drivers, shaping the option set each driver faces in such a way as to draw everyone into a safe pattern of driving activity on the roads. Importantly, there is no individual human being who controls the lights or oversees their operation: the network of lights operates according to its own internal logic—i.e., the software.

It should be obvious that the traffic system defines an enterprise that involves the determination of individual conduct through a judgment-bypassing process. On the one hand, when drivers adhere to the requirements of the arrangement, they partially surrender control over their driving activity to the network of traffic lights. The lights draw them into a certain pattern of driving activity, but the pattern cannot be attributed to the private choices of the drivers because the pattern is substantially the product of the evolving scheme of option sets that guides drivers into the pattern.

On the other hand, when drivers adhere to the requirements of the arrangement, they take part in partially bypassing one another's judgments to determine one another's conduct. The traffic system incorporates certain rules that enable the traffic lights to manage everyone's option set (e.g., "Everyone must stop at red lights," "Everyone must go at green lights"). Drivers reinforce these rules by drawing attention to the rules, criticizing rule breakers, and imposing sanctions for noncompliance. In reinforcing the rules that enable the traffic lights to manage everyone's option set and draw everyone into a certain pattern of driving activity, members of the community take part in bypassing one another's judgments to determine one another's activities.

The traffic system uses a judgment-bypassing form of social control to draw members into a certain pattern of activity. An arrangement of this kind is potentially inconsistent with the Kantian ideal. But as we saw in the previous section, an arrangement along these lines may be consistent with the Kantian ideal and avoid the charge of authoritarianism. In a city with millions of residents drivers are not in a position to gather all of the relevant information and decide together in real time how they will each get to their respective destinations. A properly structured traffic system can make up for this underlying deficiency in people's rational self-governance by putting the traffic lights in a position to draw people into the right patterns of driving activity. But in order to satisfy the Kantian ideal, the arrangement must satisfy the three requirements:

1. *Reason sensitivity*. The basic reason that the traffic system may be consistent with the Kantian ideal is that putting the traffic lights in charge of people's option sets can make up for the underlying deficiency in each person's rational self-governance. The first requirement, then, is that the system should be designed in such a way as to manage the option sets open to drivers so as to draw them into a pattern of driving activity that is actually justified in light of the relevant facts. A wide range of considerations bear on the choiceworthiness of an overall driving pattern for residents, including advancing the private goals of the drivers, distributive fairness, and environmental concerns. A traffic system should be sensitive to all of these considerations, as well as to the limitations on what is feasible.
2. *Transparency*. Even if the traffic system draws residents into a comprehensively reasonable pattern of activity, there is no guarantee that residents will actually know that this is what the coordination mechanism is doing. It may even seem at times that the mechanism is leading them into gridlock. The transparency requirement says that simply drawing residents into an attractive pattern is not enough from the standpoint of mutual respect. The traffic system must put residents in a position to understand—at an appropriate level of generality—both the pattern that the arrangement is drawing them into and the justification for this pattern. For instance, the traffic system might incorporate signs to explain to drivers why the lights are timed the way they are. The arrangement could incorporate a website or a phone app to make information about traffic patterns and the state of the roads available to drivers. These measures would serve to put drivers in a better position to see the overall pattern of activity they are being drawn into and why this pattern is justified.
3. *Trustworthiness*. A certain degree of opacity may be necessary for the traffic system to be reason-sensitive—e.g., if there is an accident in one neighborhood, it may not be possible to explain to everyone in real time why the streetlights operate differently throughout the city. Mutual respect allows for departures from full transparency in these cases, but the mere fact that some degree of opacity is required does not mean that mutual respect makes no further demands. In cases where

> transparency is lacking, residents are being asked to *trust* the system, and mutual respect requires that a coordination mechanism should give residents a reasonable basis for trust. To create a basis for trust, a traffic system can, among other things, (a) limit deviations from transparency to only those that are necessary, (b) lay out the conditions in which deviations from transparency may occur and why, and (c) when the temporary conditions that require opacity have passed, provide appropriate justifications for its operations after the fact.

To sum up, some social coordination mechanisms draw people into certain patterns of activity, regardless of their private judgments about the pattern. Arrangements of this kind involve a judgment-bypassing form of social control. For these arrangements to be consistent with the Kantian ideal of mutual respect and avoid the charge of authoritarianism, they must satisfy three requirements: reason sensitivity, transparency, and trustworthiness. The arrangement must function as an extension of the rational capacities of citizens, and it must do so in a respectful way. When an arrangement satisfies these three requirements, it relies on a judgment-bypassing form of social control, but the arrangement is not authoritarian: it is consistent with citizens respecting themselves and one another as free persons, each entitled to guide her activity in light of her own practical judgments.

5.4. A Coordination Mechanism That Relies on a Judgment-Bypassing Process but Does Not Satisfy the Three Requirements Is *Authoritarian*

I want now to pull together the central ideas of the previous two chapters. A social coordination mechanism that relies on a judgment-bypassing form of social control must satisfy the three requirements that I set out above. If an arrangement does not satisfy these requirements, it is inconsistent with the Kantian ideal and is "authoritarian." But what does it meant to criticize a social arrangement for being authoritarian? What kind of moral defect is this?

Generally speaking, authoritarianism is a moral concept that belongs to the realm of politics. We use the notion to criticize the conduct of human beings in contexts where they interact with each other with the aim of influencing one another's activities and organizing themselves into a collective pattern. We can draw an analogy between authoritarianism in a social coordination mechanism and the more familiar case of an authoritarian government.

Governments enact laws and policies to influence the behavior of citizens and draw them into certain patterns of activity. Authoritarianism is a moral defect that a government displays when it systematically draws citizens into certain patterns but does so in ways that fail to respect citizens as free persons. For example, a government may adopt laws that require citizens to act in certain ways, but the government may rig elections and bias social media in order to insulate itself from the public and make laws without regard for public opinion. Think here of contemporary regimes in China or North Korea, which adopt laws that restrict the movement of citizens and outlaw certain religious practices, and where the government never answers to the public in meaningful elections.

A social coordination mechanism that relies on a structure of mutual adjustment exhibits a similar moral defect. The public justifying rationale for the mechanism is to draw citizens into a certain pattern of activity, but the mechanism does this in a way that bypasses the practical judgments of citizens about the pattern. There is no personified authority figure in this case—e.g., no political official, no government bureaucracy—who makes rules for citizens to follow. But the arrangement still draws citizens into certain patterns in a way that is potentially inconsistent with mutual respect. The arrangement simply avoids the need for a personified authority figure by creating a system of evolving option sets that draws everyone into the pattern.

Moving beyond the core cases, we can identify a wider range of arrangements that exhibit the moral defect of authoritarianism. Take the case of an arrangement that makes widespread use of what Richard Thaler and Cass Sunstein (2008) call "nudges" and "choice architecture." The basic idea is that institutions can use certain features of human psychology to get people to act in ways that are good for them. For instance, people have a general tendency to choose the default option presented to them in a choice context in order to avoid complicated deliberations. So in order to get people to, say, make better financial choices, we could set the default terms for mortgages or credit cards to the terms that are most attractive for most borrowers, which would lead more citizens into more attractive patterns of financial activity.

Of course, it is reasonable to want people to act in ways that are good for them, but there is something morally problematic about building a social environment that secretly draws citizens into certain patterns without their being aware of it. A social arrangement that makes widespread use of nudges and choice architecture is manipulative and therefore potentially authoritarian. When citizens adhere to the requirements of the scheme, they take part in an enterprise that determines individual conduct through a judgment-bypassing process. Unless the arrangement operates in certain ways and incorporates certain mitigating features of the kind I discussed earlier, the arrangement is inconsistent with the Kantian ideal of mutual respect.

We can think of the Kantian ideal as setting out a model of open, respectful, and transparent relations between citizens as the distinctive way in which citizens respect one another's fundamental value or dignity. Social arrangements that involve secretly shaping people's activities, manipulating them, or otherwise bypassing their judgments typically embody a failure of mutual respect. These arrangements are morally defective because they are *degrading*. When we do our parts in an authoritarian arrangement, we degrade ourselves and one another by failing to treat people as having a certain dignity as persons. For many political philosophers, political degradation is usually connected with inequality, i.e., with social arrangements that accord some groups less political power or status than others. But a social arrangement can be politically degrading without inequality, when it degrades everyone by treating everyone as if they lacked a certain status or dignity. This is what we see in coordination mechanisms that are authoritarian.

I want to stress that authoritarianism is a moral defect that is not tied in a distinctive way to the use of coercion or coercive force. Most any institutional order in a modern liberal democracy will use coercive pressure to stabilize compliance with its rules. A social order that satisfies Rawls's two principles of justice, e.g., will use coercive pressure to enforce its rules. A social order that defines and protects liberal freedom will use coercive pressure to enforce its rules, as will many social orders that fail to define and protect liberal freedom. Even a social order that defines and protects a libertarian scheme of property rights will use coercive pressure to ensure that people respect one another's rights (see Nozick 1974, part I; Cohen 2011a). What distinguishes morally sound arrangements from morally defective ones is not the use of coercive force, but the *structural character* of the rules and organizing principles of the arrangement. An arrangement that conforms to Rawls's two principles is morally sound because the rules and organizing principles of the arrangement have a structure that could be endorsed by citizens, insofar as they are free and equal. The use of coercive force is a secondary issue.

Like injustice, authoritarianism is also a moral defect that a social arrangement exhibits in virtue of the structure of its rules and organizing principles. The public justifying rationale of an authoritarian arrangement is to maintain a certain pattern of activity among citizens, but the arrangement is structured to maintain the pattern through a judgment-bypassing process. An arrangement of this kind can be justified in circumstances where the arrangement operates as an extension of the rational faculties of citizens and does so in a respectful way. But outside of these special circumstances, an arrangement of this kind is inconsistent with citizens respecting themselves and one another as free persons. This failure of respect pervades the arrangement and marks it as degrading. But again, the failure has nothing in particular to do with the use of coercion to enforce compliance with its rules.

Finally, recall from chapter 4 that authoritarianism shares a number of other features with injustice. The fact that an institution is authoritarian is an objective moral defect in the scheme and counts as a powerful reason not to adopt it. If the basic institutions of our society are authoritarian, then we are all involved in an authoritarian social enterprise—this is a fact about our collective conduct. The authoritarian character of our institutions then forms the basis for a range of individual duties on citizens to do such things as vote against the current order, campaign against it, run for office, and engage in civil disobedience. Citizens in an authoritarian regime have various duties to reform or dismantle the arrangement, and we must assess the conduct of individuals in light of these civic responsibilities.

5.5. Looking Ahead: Are Advanced Market Economies Authoritarian?

In the next chapter, I return to the case of an advanced market economy. As I argued in chapter 3, when everyone adheres to the requirements of an advanced market economy, we create a system of changing option sets (i.e., the price system), which constantly draws everyone into a society-wide pattern of production activity and consumption activity that is economically efficient. But the arrangement maintains the pattern through a judgment-bypassing process. So in order to avoid the charge of authoritarianism, an advanced market economy must operate as an extension of the rational faculties of citizens and it must satisfy the three requirements discussed in this chapter. In chapter 6, I will look more closely at whether an advanced market economy avoids the charge of authoritarianism.

Let me conclude this chapter by noting that many philosophers and economists draw a sharp distinction between governments and markets. But a central theme in the previous two chapters has been to show that this distinction is exaggerated. Governments involve centralized authority, while markets involve decentralized individual choices—this much is true. But governments and markets represent two different approaches that a social coordination mechanism can use to draw citizens into and maintain a certain pattern of activity. In this vein, political scientists often refer to political authority structures and markets as two different forms of *governance*, two different approaches that a community can take to maintain some valuable pattern in its activities (see Bevir 2012). "Governance" is a useful term: it allows us to talk about "political governance" and "market governance" as two different approaches to maintaining patterns. It also allows us to talk about structures of mutual adjustment as "governance without a government." Most important, the term brings into focus the way that political authority structures and market arrangements are both ways of governing human beings, and as such they are both subject to similar moral standards and may exhibit similar moral defects, e.g., authoritarianism.[4]

[4] I take it that this is one of Marx's (1967) central points in *Capital*, particularly in part I, chapter I, section 4 ("The Fetishism of Commodities and the Secret Thereof"). Here Marx is arguing that the market is a coordination mechanism. Members of a market society adhere to the rules of private ownership, exchange, and mutual disinterest, and in doing so, they unwittingly impose on themselves an external process that constantly draws them all into certain society-wide patterns of production activity and consumption activity.

Marx typically thinks of these society-wide patterns as evolving over time toward a pattern that maximizes the sum total of resources in society that circulate as "capital," i.e., as elements in processes that generate profit for its own sake. But for the purposes of the argument in this book, I do not follow Marx's account of what sorts of patterns market coordination draws people into over the long run. I make no assumptions about "dynamic efficiency." I simply accept the mainstream economic view of "static efficiency": an advanced market economy approximates an arrangement in which the equilibrium state of market-oriented production activity and market-oriented consumption activity is a pattern that is Pareto optimal for the current generation.

I do follow Marx, however, in his view that the market is a mechanism of "governance": (a) it is a coordination mechanism that relies on a judgment-bypassing form of social control, and (b) it is subject to the same types of moral standards that apply to authority structures and other systems whose justifying aim is to control and direct human behavior.

6

Does a Liberal Market Democracy Satisfy the Anti-Authoritarian Ideal?

An advanced market economy maintains a society-wide pattern of production and consumption activity that is economically efficient. But it does so through a process that bypasses the practical judgments of citizens about the pattern. An arrangement of this kind is potentially authoritarian: it may be inconsistent with citizens respecting themselves and one another as free persons, each entitled to guide her activities in light of her own practical judgments. As we saw in the previous chapter, to avoid the charge of authoritarianism, an arrangement of this kind must satisfy three requirements: reason sensitivity, transparency, and trustworthiness. Does an advanced market economy satisfy these requirements?

In this chapter, I argue that it does not: as a stand-alone mechanism, an advanced market economy is an authoritarian system. Philosophers often fail to appreciate the point because we adopt a depoliticized view of market coordination that does not situate the process in its political context. I go on to examine whether a more complex arrangement can avoid the charge of authoritarianism. A *liberal market democracy* is an arrangement that embeds an advanced market economy in a regulatory process and a democratic legislative process to make up for certain deficiencies in market coordination. I argue that even this more complex arrangement fails to satisfy the three requirements. The upshot is that to avoid the charge of authoritarianism, a social order must embed an advanced market economy in a set of institutional arrangements that go beyond the standard mechanisms of liberal market democracy.

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6.1. An Advanced Market Economy Must Satisfy the Three Requirements

When members of a political community adhere to the requirements of an advanced market economy, they create an environment in which the price system presents citizens with an array of option sets. These option sets are constantly changing in such a way as to draw everyone into an economically efficient pattern of production activity and consumption activity. But the arrangement draws people into an efficient pattern through a judgment-bypassing process. As such, the arrangement suffers from a potential moral defect—i.e., authoritarianism. The arrangement is potentially inconsistent with citizens respecting themselves and one another as free persons, each entitled to guide her activities in light of her own practical judgments. The defect is potential, however, because a judgment-bypassing form of social control may be consistent with the Kantian ideal of mutual respect under certain conditions.

For the purposes of this chapter, I will assume that one of these conditions is typically satisfied in developed liberal democracies. Citizens in a large and complex society are usually not in a position to organize on their own their production activities and consumption activities in light of all of the relevant practical considerations. There are enormous obstacles simply to *gathering* the relevant information in real time, let alone to processing this information, conducting a deliberation, and organizing people's activities in response to a decision (see Hayek [1945] 1996). An advanced market economy has the potential to make up for this deficiency in citizens' rational capacities by drawing them into a comprehensively reasonable pattern of activity on their behalf. But in order for the arrangement to do this *and* avoid the charge of authoritarianism, it must also satisfy the three requirements discussed in chapter 5.

In the next three sections, I consider a restricted scenario in which an advanced market economy functions as a *stand-alone institution*. Imagine a society that has the constitutive elements of an advanced market economy, including institutional rights, duties, and powers, such as the power to buy and sell goods, the power to set up a business corporation, and the various duties associated with mutual disinterest (see chapter 1). Society also has an array of bureaucratic agencies whose function is to make sure that the mutual adjustment process in the market maintains an efficient pattern of economic activity. Among these agencies, we can include agencies that oversee monetary policy (e.g., the US Federal Reserve System) and agencies that ensure that markets are competitive (e.g., the Antitrust Division of the US Department of Justice).[1]

What is missing in the restricted scenario are many of the other institutions and agencies that we take for granted in contemporary liberal democracies. Most important, society lacks a regulatory process and a legislative process that adjust the rules of market coordination and adjust market outcomes for the sake of other social values besides economic efficiency.[2] For example, there are no regulatory agencies that make rules to preserve the environment for future generations (e.g., the US Environmental Protection Agency) or to ensure accessibility for the handicapped (e.g., enforcement agencies for the Americans with Disabilities Act). Society also lacks various "agencies of reflection" which examine market activity and foster a public understanding of its ongoing development: newspapers, magazines, websites, universities, government agencies that gather and disseminate information about market activity (e.g., US Department of Labor, US Department of Commerce), etc.

In the restricted scenario, society basically has an advanced market economy and little else: no legislative process or regulatory process to address concerns besides efficiency and no agencies of reflection. The point of considering this restricted scenario is to bring into focus some inherent deficiencies of an advanced market economy as a stand-alone institution. Thinking about these deficiencies will then prepare the way for the central question in section 6.5, which is whether a standard liberal market democracy can make up for these shortcomings or whether further mechanisms are required.

6.2. As a Stand-Alone Mechanism, an Advanced Market Economy Does Not Satisfy Transparency

Let's start with transparency. To be consistent with mutual respect, a judgment-bypassing coordination mechanism must draw citizens into a comprehensively reasonable pattern of activity. But as we saw in chapter 5,

[1] The agencies in the restricted scenario may encompass a set of activities that do not correspond precisely to the activities of any existing government agency since actual government agencies typically perform several different social functions.

[2] By "economic efficiency" here I mean a pattern of production and consumption activity that is Pareto optimal for the existing members of society. See chapter 3, note 6.

drawing citizens into a reasonable pattern of activity alone is not enough. Mutual respect requires that an arrangement must also be designed to put people in a position to see, at an appropriate level of generality, the pattern that the arrangement is drawing them into and the justification for this pattern. In the case of a traffic system, the arrangement must draw citizens into a safe and efficient pattern of driving activity, and it must put citizens in a position to see that the patterns it is drawing them into are safe and efficient.

Considered as a stand-alone institution, an advanced market economy does not satisfy the transparency requirement. I will use a pair of examples to make the point. The examples are meant to illustrate what the opacity of market coordination looks like from the perspective of a citizen taking part in market activity. Here is the first example:

> **Healthcare.** A group of workers {A . . . Z} currently hold jobs in the automotive industry. They each have a set of consumption options open to them in virtue of their wages. They also have a set of alternative job possibilities in the industry. All of the options open to {A . . . Z} exist in part because consumers make (and are prepared to make) certain buying choices. Suppose one day that consumer preferences change: people are less interested in driving and more interested in new forms of healthcare. Over time, consumers buy fewer cars. Firms move resources out of car production and into healthcare. Members of {A . . . Z} see their option sets change: their opportunities in the automotive industry dwindle, while their opportunities in healthcare expand. Eventually these changes in their option sets shift every member of the group to new patterns of production activity, i.e., from producing cars to providing healthcare.

The healthcare case begins with a change in social circumstances: consumer preferences change—people are less interested in driving and more interested in healthcare. This change pushes society off the efficiency frontier. What follows is a cascading series of adjustments that moves society back toward an efficient pattern of production and consumption: consumers buy fewer cars; firms move resources from car manufacturing to other activities; workers have fewer opportunities in the automotive sector; workers move from car manufacturing into healthcare; etc. The process of adjustments continues until the system eventually comes to rest in a new equilibrium pattern of production and consumption activity that is economically efficient given the circumstances.

Suppose that the new equilibrium pattern of production and consumption activity in the healthcare example is comprehensively reasonable. Since citizens are actually less interested in driving, there is good reason for the community to move from a pattern that is mainly focused on producing and consuming cars to a pattern that is more focused on producing and consuming healthcare. Even if this change in the pattern of production and consumption activity in society is justified, the important point for my purposes is that nothing about the market coordination process puts the individual members of society {A . . . Z} in a position *to judge for themselves* what the new pattern is and whether it is justified.

Take a representative worker in the group—say, worker A. What A sees from her perspective is a gradual change in her option set. This will appear as declining wages and benefits in the automotive industry, fewer opportunities for overtime, plant closures, etc. All these changes mean that she has fewer and less attractive job opportunities in the automotive sector. At the same time, she will see an improvement in her overall opportunities in the healthcare sector. But nothing about these various changes in A's option set will communicate to her what the overall pattern of production and consumption activity is that she—and everyone else—is being drawn into. Moreover, nothing about these various changes puts A in a position to assess whether the emerging pattern is justified. For all A knows, the emerging pattern might *not* be justified—the new pattern may be one in which low-cost manufacturers simply take advantage of weak environmental and labor standards. Nothing about the market coordination process puts A in a position to make an assessment.

What holds for producers in an advanced market economy also holds for consumers. Consumers may also find that their option sets change in ways that eventually move them from one set of consumption activities to another. But market coordination does not provide them with any explanation for why the new pattern of production and consumption activity in society is justified. Consider the following:

> **Heating Your Home.** A group of homeowners {A . . . Z} heat their houses with oil. Each homeowner has different options for heating her house, and these options affect what other forms of consumption are open to her. Over time, the price of oil increases, effectively scaling back the consumption possibilities open to those who heat their houses with oil. By contrast, the price of natural gas falls, increasing the options available to those who

heat their houses with natural gas. At a certain point, the shrinking options available to oil users and the expanding options available to natural gas users lead each member of the group {A . . . Z} to shift from using oil to using natural gas.

From the social point of view, there may be good reason for citizens to move from a pattern organized around the production and consumption of oil to a pattern organized around the production and consumption of natural gas. Among other things, natural gas burns more cleanly and therefore has various environmental benefits. But market coordination does not put citizens in a position to see for themselves what the emerging pattern of production and consumption is and whether it is justified. This opacity holds whether we are talking about producers or about consumers (or, for that matter, about investors and entrepreneurs).

Note that the lack of transparency that I am calling attention to here is a widely recognized feature of an advanced market economy. In "The Use of Knowledge in Society," Friedrich Hayek ([1945] 1996) famously notes that price coordination does not communicate to market actors all of the information that might justify a certain pattern of production and consumption activity in society. What the system does do is provide each actor with all of the information that she needs to adjust her individual activities in the "right" way, according to Hayek, i.e., in a way that moves society closer to a pattern that is economically efficient. Hayek accepts that the market process is opaque, but he thinks that this is a good thing because market actors would be overwhelmed with information if they were required to make production and consumption decisions based on a full awareness of all of the relevant economic and political considerations. Hayek's argument has certain weaknesses as a moral defense of market coordination, but my point now is simply to emphasize that most observers recognize that the market process has a certain degree of opacity built into it.[3]

[3] On my view, Hayek is essentially defending a form of authoritarianism. He argues that market coordination achieves attractive social objectives and that it could not achieve these objectives as effectively without certain departures from the requirements of mutual respect (e.g., the requirement of open, communicative coordination among citizens). Hayek is right that speed and efficiency are important, but speed and efficiency are not everything when it comes to the coordination of activities among citizens. Authoritarian regimes often defend their practices on the grounds that democracy is just too slow and inefficient.

6.3. As a Stand-Alone Mechanism, an Advanced Market Economy Does Not Satisfy Reason Sensitivity

Turn now to reason sensitivity. To be consistent with mutual respect, a judgment-bypassing coordination mechanism must be responsive to the full range of considerations that bear on the organization of a certain domain of social activity. From the social point of view, a pattern of production activity and consumption activity in society must answer to the goals of citizens as private individuals—i.e., citizens should end up with resources that will enable them to pursue their respective conceptions of the good. This value is closely related to the idea of economic efficiency. But many other considerations bear on a pattern of economic activity for a modern society besides advancing the private goals of citizens. Among other things, we should care about distributive fairness, environmental considerations, and the protection of human rights. [4]

As we saw in chapter 3, an advanced market economy draws citizens into a pattern of production and consumption activity that is economically efficient given the preferences of existing members of society. The arrangement is therefore sensitive to considerations that are conceptually or causally related to this form of efficiency. But for much the same reason, an advanced market economy is *not* sensitive to considerations that are unrelated to this form of efficiency. It follows that an advanced market economy does not satisfy the reason sensitivity requirement.

I will illustrate with three examples that show what the irrationality of the market coordination process looks like from the perspective of citizens taking part in market activity. Again, I will focus on an advanced market economy understood as a stand-alone mechanism, separate from other background institutions:

Fossil Fuel. Excess Petroleum is engaged in a long-term project to develop various techniques to extract oil from arctic oil deposits. Extracting oil from these sources would greatly expand the sum total of fossil fuels available for global consumption and thereby worsen climate change. Suppose that, as a

[4] I take it for granted here that there are objective, preference-independent values and ideals that determine the structure of production and consumption activities. I take it that Pareto optimality, if it is indeed a normative ideal, must be understood as an objective standard for assessing states of affairs, a standard whose normative significance does not depend on the content of individual preference orderings.

matter of fact, extracting and consuming oil from these new sources would violate the obligation of current citizens to future generations. Market co-ordination is not sensitive to the moral obligation. The prices consumers face at the gas pump convey no information about the impact of fossil fuel consumption on the environment, so consumers are prepared to buy certain types of fuel, whether or not the production of these fuels is compatible with the obligation. Since consumers are prepared to make choices this way, producers face an option set that draws them into producing certain fuels, regardless of whether their doing so is consistent with the social obligation to future generations. As a result, the market process draws citizens into a pattern of production activity and consumption activity that worsens climate change and violates their obligations to future generations.

Drug Company. You are a research scientist at BSK, a large pharmaceutical company. Your team has developed a new drug, and the company conducts tests to determine whether it is safe for public consumption. After conducting a number of tests, you and your team discover a problem in the company's testing methodology. There is some chance that the test results are mistaken. Suppose that, as a matter of fact, the company has a moral obligation to withhold the drug from the market in order to perform more tests. Market coordination is not sensitive to the moral obligation. Prices typically convey no information to consumers about whether producers (e.g., firms, employees, executives) have satisfied their obligation of due care, so consumers are prepared to purchase certain drugs whether or not producers have satisfied their obligations. Since consumers are prepared to make purchases this way, producers such as BSK face an option set that draws them into the production of certain drugs whether or not they can produce these drugs while also satisfying their obligation of due care. As a result, the market process draws citizens into a pattern of production activity and consumption activity that violates both individual and corporate obligations of due care.

Housing Market. You own a house in Brooklyn. The borough is in the midst of a huge increase in home prices. Because of various demographic factors, wealthier families that can buy homes at higher prices tend to be white, while poorer families that rent (and face evictions) tend to be Black or Hispanic. Suppose that there is a moral "imperative of integration" that requires citizens in a democratic society to live in neighborhoods that

> cross important ethnic and racial boundaries (Anderson 2010). Home prices do not convey any information to home buyers about how buying certain houses will reshape the ethnic makeup of neighborhoods, so potential homebuyers are prepared to make buying decisions whether or not these are compatible with the democratic imperative of integration. Since homebuyers are prepared to make decisions this way, the option sets that sellers face draw them (and everyone else) into a pattern of residential segregation, regardless of whether this pattern is consistent with democratic ideals.

Each of these three examples illustrates the same feature of an advanced market economy. From the social point of view, a wide range of considerations bear on how citizens should organize their production and consumption activities. Some of these considerations are related, directly or indirectly, to a pattern of activity that is economically efficient for the current generation. But many considerations are not, and the market coordination process is not sensitive to these other considerations. In "Fossil Fuel," market coordination draws citizens into a pattern of production and consumption activity that does not respond to considerations of intergenerational justice and environmental stewardship. In "Drug Company," market coordination draws citizens into a pattern of production and consumption activity that does not respond to considerations stemming from the obligation of due care for public safety. And in "Housing Market," market coordination draws people into a pattern of production and consumption activity that does not respond to considerations of social integration. To the extent that an advanced market economy is not sensitive to these other considerations, it does not satisfy the reason sensitivity requirement.

6.4. As a Stand-Alone Mechanism, an Advanced Market Economy Does Not Satisfy Trustworthiness

Last, there is trustworthiness. With respect to economic life, it is often the case that the only way to maintain a comprehensively reasonable pattern of production activity and consumption activity in society is by putting citizens in a position where they cannot see what kind of pattern an economic arrangement is drawing them into and whether this pattern is justified. In these cases, mutual respect requires that a coordination mechanism such as an advanced market economy provide citizens with a reasonable basis for trusting that the arrangement is drawing them into a comprehensively reasonable pattern and that it limits departures from transparency to those that are justified on the grounds of reason sensitivity.

Focusing again on an advanced market economy as a stand-alone mechanism, the arrangement does not satisfy the requirement of trustworthiness. First, as we saw in section 6.3, an advanced market economy suffers from a general failure with respect to reason sensitivity: market coordination is not sensitive to considerations that bear on the pattern of production activity and consumption activity in society when these considerations are not tied to economic efficiency. Since an advanced market economy is insensitive to these other considerations in general, there is no reasonable basis for citizens to trust that the market coordination process will be sensitive to these considerations in cases where it operates in an opaque fashion.

Second, as we saw in section 6.2, an advanced market economy suffers from a general failure with respect to transparency: the market coordination process generally does not put citizens in a position to see what pattern it is drawing them into or whether this pattern is justified. All that citizens see from their various standpoints are the changing option sets that are open to them in virtue of prices. Since market coordination does not satisfy transparency in general, there is no reasonable basis for citizens to trust that an advanced market economy will limit departures from transparency only to those cases in which these departures are justified for the sake of reason sensitivity.

By way of summing up the restricted scenario, consider the following. Imagine that you live in a large city, where the traffic system relies on a network of traffic lights. The rules of the system are coercively enforced, and there is no human agency overseeing the operation of the lights: the lights have final control over your and everyone else's option sets. As the lights open and close the doors, they lead you and the other drivers into a certain overall pattern of driving activity. But imagine that the lights regularly lead all of you into dangerous situations (e.g., four-way green lights) and large traffic jams. The system incorporates no measures to explain to you why it is drawing you into certain patterns rather than others. And you have no reason to trust the system to draw you into good patterns when it operates in an opaque fashion or to properly limit departures from transparency. A traffic system along these lines is inconsistent with the ideal of mutual respect among citizens and is therefore authoritarian. It is also a good intuitive model for thinking about the deficiencies of an advanced market economy, considered as a stand-alone institution.

6.5. The Regulatory Process and the Legislative Process Have a Limited Capacity to Compensate for the Deficiencies of Market Coordination

We come now to the key question. In the previous three sections, we looked at an advanced market economy as a stand-alone institution and found that it does not satisfy the three requirements. It may be possible, however, to combine an advanced market economy with other background institutions that compensate for its shortcomings. A more complex social arrangement may be able to satisfy the requirements of political morality better than an advanced market economy on its own. This leads to what I call the *functionalist view of liberal market democracy*.

According to the functionalist view, a liberal market democracy consists of various component institutions. Each component has a different function, and when the components each fulfill their allotted function, the arrangement as a whole will satisfy the requirements of political morality. The function of the market economy in the arrangement is to maintain a pattern of production activity and consumption activity that is economically efficient. The function of the regulatory process and the democratic legislative process is, among other things, to make up for the fact that market coordination is not sensitive to considerations stemming from other values besides efficiency. The regulatory process and the legislative process monitor market activity, adjust the rules of market interaction, and adjust market outcomes after the fact so as to ensure that the actual pattern of production activity and consumption activity in society is sensitive to the full range of relevant values.

An advocate for the functionalist view might articulate it as follows:

> **Functionalist view of liberal market democracy.** "The market performs a certain function in society: it continuously draws people into a pattern of production activity and consumption activity that is economically efficient. In performing this function, the market may not be sensitive to social values such as environmental stewardship or distributive justice, but this is where government agencies and democratic politics come in. The

regulatory process and the legislative process can ensure that the pattern of economic activity in society is not only efficient but also sensitive to other values besides efficiency. When the various components of the system each perform their allotted function, they form a more complex arrangement that can satisfy the requirements of political morality."

We can find a good illustration of the functionalist view of liberal democracy in Rawls's conception of a property-owning democracy (see especially Rawls 1999, 242–51; see also Dworkin 2000, chapter 2). In *A Theory of Justice,* Rawls offers a sketch for a liberal market democracy that could satisfy the requirements of justice as fairness. The scheme is based on "pure procedural justice," which means that it is designed in such a way that, as citizens exercise their various rights and powers, the distribution of resources that results is just, whatever citizens decide to do. The arrangement starts with a market economy that defines various powers of private ownership and exchange. The market economy is then embedded "within the surroundings of suitable political and legal institutions" (Rawls 1999, 243).

Among these surrounding institutions, there are two functionally defined branches of government: the "allocation branch" and the "stabilization branch." Together, these two branches "are to maintain the efficiency of the market economy generally" (Rawls 1999, 244). Next, there is the "transfer branch," which uses family allowances, unemployment payments, and other income supplements to provide a guaranteed minimum to all citizens. The "distribution branch" imposes inheritance taxes to disperse large concentrations of wealth, and expenditure taxes to raise revenues for public goods and social transfers. Finally, there is a legislative process, i.e., a just political constitution that protects liberal freedom and creates a fair process for choosing governments and enacting just legislation.

The various components of a property-owning democracy have their allotted functions in the overall arrangement. Most important for my purposes, market coordination, overseen by the allocation branch and the stabilization branch, is supposed to draw citizens into an efficient pattern of economic activity: "Competitive markets properly regulated . . . lead to an efficient use of resources and allocation of commodities to households" (Rawls 1999, 244). But an efficient pattern may be highly unjust in the way that it distributes benefits in consumption (e.g., income). Here it is the function of the transfer branch and the distribution branch to establish a scheme of taxes, transfers, and public goods to satisfy the difference principle by ensuring a basic minimum that maximizes the long-run expectations of the least advantaged group in society. In this way, the regulatory process and the legislative process adjust the actual pattern of production activity and consumption activity in society to make up for the deficiencies of market coordination, and the scheme as a whole satisfies the requirements of justice as fairness.

From Rawls's discussion, we can see that the functionalist view of liberal market democracy is widely endorsed and politically significant. Many people believe that an advanced market economy is morally defective as a stand-alone mechanism, but that a liberal market democracy can combine an advanced market economy with a regulatory process and a legislative process in such a way that the arrangement as a whole satisfies the requirements of political morality. The question is: How plausible is the functionalist view of liberal market democracy when it comes to satisfying the requirements of the Kantian ideal of mutual respect? Can a liberal market democracy that combines an advanced market economy with a regulatory process and a democratic legislative process satisfy the three requirements I set out?

I believe that the answer is no. A social order that incorporates an advanced market economy cannot avoid the charge of authoritarianism simply by embedding the market in a regulatory process and a democratic legislative process: something more is required to supplement these institutions. There are two main problems with the functional view when it comes to mutual respect.

6.5.1. The Regulatory Process and the Legislative Process Have a Limited Capacity to Compensate in Real Time

The first problem has to do with reason sensitivity. Given the realities of life in a large and complex liberal democracy—particularly with respect to time—it is difficult to see how the regulatory process and the legislative process could continuously make the adjustments necessary to maintain a comprehensively reasonable pattern of economic activity in society. In fact, there is no liberal market democracy in the world today where the regulatory process and the legislative process continuously make the necessary adjustments to market rules and market outcomes. At a minimum, the regulatory process and the legislative process lag far behind market developments, often taking years or decades to respond to changes.

The utopian character of the functional view is not hard to see. Take the case of distributive justice. In recent years, the compensation packages offered to CEOs in large corporations have increasingly come to rely on stock options rather than salaries. Tax systems in countries such as the United States and Canada tend to rely on progressive income taxes to achieve various redistributive goals. But in offering compensation through equity returns, the pattern of CEO compensation in the market has evolved in a way that eludes the redistributive elements of the taxation system. This evasion is not necessarily intentional, but it has very significant effects, effects that compound over time and across jurisdictions in a globalized economy (Piketty 2014). Most important, *it has been almost 25 years* since CEO compensation shifted substantially in the direction of stock options, yet little has been achieved in terms of bringing these forms of compensation under control.

Many factors lie behind the inability of the regulatory and legislative processes in general to keep up with changes in market activity. The four most important factors for my purposes are structural:

1. *Epistemic limitations*. Market activity is so wide ranging, so dense, and so complicated that it is extremely difficult to formulate a reasonably accurate picture of what is happening in the market and where regulatory attention is needed. The problem involves both the challenges inherent in monitoring the wide range of activities in market life and the challenge of centralizing information and figuring out what to do. For example, large investment banks had been assembling complex mortgage-backed securities for *over 10 years*, generating significant systemic risk for the financial system and setting off wide-ranging changes in the commercial real estate market, before the collapse of Bear Stearns in 2008 and an acute crisis of confidence in capital markets finally brought the full scope of the problem to light and led regulators to address the situation (Blinder 2013; Reinhart and Rogoff 2009).
2. *Anarchic innovation*. Market actors are always innovating, and this leads them, intentionally or unintentionally, into patterns of activity that do not fall within the scope of the current regulatory framework. Market activity is *constantly* moving beyond current regulatory standards, and this means that a great deal of market activity essentially unfolds beyond the scope of regulatory oversight. Uber, Lyft, and Airbnb are all good examples: these companies operate in such a way that they are not subject to ordinary labor and zoning restrictions,

which means that economic activity within these organizations—and the "share economy" more generally—unfolds outside the scope of these regulations.

But to fully appreciate the scope of the problem, consider that each of the major investment banks and tax firms in the United States employs thousands of legal experts whose job is to help clients minimize their tax burdens. Constant innovation by these actors has led to a set of worldwide practices—e.g., transfer pricing and offshore tax shelters—that move an estimated *US$1 trillion annually* beyond the reach of tax codes around the world (Zucman 2015). These practices work not so much by breaking the law as by going far beyond the scope of existing regulations.

3. *Obstacles to political mobilization*. It is extremely difficult for people to come together in a mass democracy to form a legislative coalition that can effectively deal with something as complicated and wide ranging as, say, the tax system. The process consumes scarce social resources—e.g., media airtime, public attention, policy expertise, political goodwill—so only a certain number of issues can make it onto the political agenda. This means that every social decision that a community places within the purview of market coordination is a decision that is going to be made primarily on the basis of efficiency considerations without regard for other social concerns, where the only way to overturn the decision is through an extremely difficult and resource-intensive legislative intervention.
4. *"Genie in a bottle" issues*. Market actors are always innovating, leading them to introduce new technologies into the production process. In many cases, these new technologies create potential hazards that can be addressed through regulatory oversight before the fact. But the nature of the hazards involved are such that once these technologies are widely introduced into the production process—i.e., "when the genie is out of the bottle"—it becomes almost impossible to address through regulatory oversight the danger to the public. For example, agricultural producers have in recent years used various techniques to develop genetically modified crops, which may pose various health dangers to the public. Regulations can address the potential dangers of these new crops before they have been introduced into the natural environment. But once introduced, genetically modified seeds mix naturally with the wider seed population—e.g., through wind dispersion—and

> it becomes almost impossible to remove certain genetic modifications from the agricultural gene pool. "Genie in a bottle" issues present another range of cases where regulatory oversight cannot keep up with changes in market activity.

What we see in the case of CEO compensation and taxation is common across a wide range of issue areas. From systemic financial risk to consumer safety, from climate change to gender discrimination and economic inequality, market activity is so wide ranging, so dense, and so complicated that it is hard to imagine how any centralized bureaucratic agency or centralized rule-making process could continuously and smoothly adapt to changes in market activity in real time.

6.5.2. The Regulatory Process and the Legislative Process Have a Limited Capacity to Compensate for Deficiencies in Transparency

The second problem has to do with transparency. Liberal market democracies today rely implicitly on a range of institutions and professions to satisfy the transparency requirement. Prominent among these are government agencies (e.g., US Department of Commerce), NGOs (e.g., the IMF), journalists, and academics (e.g., economists, sociologists, climate scientists). These institutions and professions examine market activity, identify trends, and develop accounts of whether emerging patterns of market activity are justified. In recent years, some trends that have attracted attention are global trade imbalances, rising income inequality, the persistent gender pay gap, outsourcing, the accumulation of big data, and the expanding use of automation and artificial intelligence.

No doubt existing institutions are important, but the framework of transparency in its current form falls short of what is required from the standpoint of mutual respect. The most important problem is that the framework does not penetrate the corporate boardroom or the financial system. In many cases, important changes in the overall pattern of production activity in society are visible only if you have access to the kinds of information that corporate executives and board members have available to them. Corporate officers make important decisions about the use of new technologies or the division of surplus between workers and shareholders, and knowing about these decisions and their possible ramifications is essential to understanding how social patterns of economic activity are changing. Furthermore, strategically positioned actors can play an important role in determining which of several possible Pareto optimal patterns of economic activity is actually realized through the market process. The relevant actors are not just corporate executives and institutional investors but also millions of anonymous traders in financial markets who exert a constant influence on the decisions of corporate officials through share prices. Yet existing institutions of transparency have a limited capacity to penetrate these centers of economic coordination, identifying the patterns they are leading us into and the possible justification for these patterns.

A good illustration has to do with pensions. In the 1990s and early 2000s, corporate officials and investors in the United States dismantled a society-wide system of employment-based pensions, one company at a time. A profoundly different pattern of economic activity has now emerged in which millions of citizens previously covered by a pension scheme face substantially worse prospects as they grow older. Unfortunately, there was barely any public consciousness of the social transformation while it was happening, as each decision was understood primarily as a financial decision by individual firms and their shareholders. Without a mechanism to introduce more transparency about the social ramifications of decisions in the corporate boardroom and financial markets, a market arrangement cannot satisfy the requirements of transparency and avoid the charge that it is an authoritarian form of social coordination.

6.6. An Ideal Regulatory State Is Not Part of "Ideal Theory" in Normative Political Philosophy

At this point, some philosophically minded readers might raise an objection. The argument just leveled against the functionalist view of liberal market democracy emphasizes various facts about how liberal market democracies operate in the real world. But many might argue that the argument improperly shifts the discussion from what political philosophers call "ideal theory" to what we call "nonideal theory." Maybe the issues I have been raising are issues that we can set aside when thinking about principled arguments for and against various sociopolitical arrangements?

Here I want to stress that the issues I raise must not be set aside for the purposes of ideal theory in political philosophy. To see why, note first that when political philosophers assess different types of institutional arrangements in the context of ideal theory, we assess these arrangements within the framework of two main assumptions: "full compliance" and "favorable background conditions" (Rawls 1999; Simmons 2010). On the one hand, we assess arrangements assuming that individual members of society conform to their institutional obligations. On the other hand, we assess arrangements assuming that social conditions fall within the realm of ordinary circumstances, not specifically hostile to one type of arrangement or another. Making these assumptions allows us to assess different institutional arrangements as different schemes of rules and organizing principles that the members of a community could collectively adopt as a coordinating structure for their activities (see section 4.1).

Consider, e.g., judicial review. Some forms of democracy incorporate a mechanism whereby judges can overrule majority decisions by appeal to a more fundamental scheme of constitutional rules, such as a bill of rights. Other forms of democracy allow for a more unrestrained form of majority decision-making, unconstrained by judicial review. Now in assessing these forms of democracies, political philosophers might compare two possible democratic arrangements, one with judicial review and one with unrestrained majoritarianism. For the purposes of ideal theory, we assume that legislators, judges, policies officers, citizens, and others will all do what is required of them under each arrangement, and we assume that society is in a more or less normal state—not on the brink of starvation or civil war. By making these assumptions, we bring into view the inherent merits of two different practical proposals, two different schemes of rules for how to organize a democracy. And the answers that we get at this level can guide us in addressing a range of questions about how to reform existing institutions and what to do if some people are not living up to their institutional obligations.

Note that part of what we are doing in ideal theory is looking at how well different institutional arrangements can deal with *the fundamental realities of social life*. In assessing unrestrained majoritarianism, we take into account basic social facts, such as the presence of minority groups in society and the possibility that majority groups will be attracted to mistaken views about the civil liberties of minorities. These facts are among the basic social and political realities that an institutional arrangement must deal with, so they are an essential part of assessing different political arrangements in ideal theory.[5]

Return now to the arguments I leveled against the functional view of liberal market democracy. I take it that facts such as the scope, density, and complexity of market activity are among the basic facts of modern social life. The same can be said of epistemic limitations, anarchic innovation, the challenges to political mobilization, and "genie in a bottle" issues. *The point of ideal theory is not to ignore these facts*. The point is to assume full compliance and reasonably favorable background conditions, and assess how well different institutional arrangements deal with these facts. My argument in the previous section criticizes an institutional arrangement that gives very wide scope to market coordination for being structurally inadequate to deal with the complexities involved in managing a massive coordination scheme of this kind—some further mechanisms of oversight are necessary. This falls clearly within the scope of ideal theory.

Let me add that the assumptions that define ideal theory for political philosophers should not be confused with the assumptions that economists and political scientists sometimes make for other purposes. In order to develop a theoretical understanding of how markets function, economists sometimes assume the existence of an ideal regulatory state that can define a "complete" set of property rights, internalize externalities, and maintain a perfect regulatory framework in real time. These idealizations play a role in formulating explanations for various social phenomena in terms of rational market behavior, but they represent a serious abstraction from social and political realities and they have no place in ideal theory in normative political philosophy.

The arguments leveled against the functionalist view of liberal market democracy in the previous section fall within the scope of ideal theory in political philosophy. The arguments show that a social order that incorporates an advanced market economy cannot avoid the charge of authoritarianism

[5] I should add that there is a difference between ideal theory with respect to social institutions and ideal theory with respect to principles of social justice. In the latter case, full compliance typically involves an assumption both that individuals fulfill their institutional obligations and that institutions conform to the requirements of the various proposed principles of justice. But ideal theory at the level of institutions does not require that everyone actually acts as the principles of justice require. At this level, we assume that people are *motivated* to act justly, but assess different social arrangements—e.g., judicial review—in terms of how well they would conform to the aims of social justice given reasonably supportive motivations among individuals.

simply by embedding the market in a regulatory process and a democratic legislative process. The upshot of the argument, as I understand it, is not that we must give up on an advanced market economy, but rather that we must embed an arrangement of this kind in institutions that go beyond the standard framework that we find in most liberal market democracies today. In chapter 8 I will discuss one example of an institution that goes beyond the standard framework, namely codetermination.

6.7. Putting Pattern Maintenance at the Center of Our Thinking about Markets and Freedom

We have reached the end of a long argument. The argument began in chapter 3 with the aim of setting out a new conception of the relationship between markets and freedom. Over the course of chapters 3, 4, 5, and 6, I defended a series of claims that together define this new conception. Let me recap the central claims:

1. An advanced market economy is a social coordination mechanism whose public justifying rationale is to draw citizens into an economically efficient pattern of production activity and consumption activity.
2. An advanced market economy maintains an efficient pattern of production activity and consumption activity by means of a structure of mutual adjustment, which draws citizens into an efficient pattern through a process that bypasses the practical judgments of individuals about the pattern.
3. The Kantian ideal of mutual respect requires that a social institution must be consistent with citizens respecting themselves and one another as free persons, each entitled to guide her activities in light of her own practical judgments.
4. To be consistent with the Kantian ideal of mutual respect and thereby avoid the charge of authoritarianism, a social order that incorporates an advanced market economy must satisfy three requirements: reason sensitivity, transparency, and trustworthiness.
5. A liberal market democracy that embeds an advanced market economy in a regulatory process and a democratic legislative process goes *some* of the way toward satisfying the three requirements.

6. A liberal market democracy must supplement the regulatory process and democratic legislative process with social governance mechanisms that go the *rest* of the way toward satisfying the three requirements.

According to the new conception, a social order that incorporates an advanced market economy answers to the value of freedom partly insofar as it is reason-sensitive, transparent, and trustworthy. This feature of the view may be surprising to many readers. After all, we typically think of a market arrangement as answering to the value of freedom insofar as it provides citizens with a wide range of valuable options to choose from, in terms of both jobs and consumer goods. We don't typically think of a market arrangement as answering to the value in virtue of these other features. I want to say something more here to explain this unusual feature of the view.

Perhaps the central issue has to do with the moral nature of an advanced market economy (see chapter 3). We often think of a market economy simply as a neutral mechanism for generating options for people to choose from. This is the typical perspective of a consumer looking to buy something at the grocery store or a worker looking at job listings on the web. But an advanced market economy is not simply putting people in a position to make one-off choices from a given option set. The arrangement creates conditions in which people's option sets are constantly evolving, and evolving in such a way as to draw everyone into a certain pattern of activity. As such, the market is a *mechanism of social control*, whose public justifying rationale is in part to generate and maintain a certain pattern in people's activities. The provision of option sets is one part of the overall process that generates and maintains the relevant pattern.

In his seminal work on freedom, Amartya Sen (1999, 2002) argues that freedom has an "opportunity aspect" and a "process aspect." A social arrangement answers to the opportunity aspect by providing people with a wide range of valuable options to choose from. An arrangement answers to the process aspect by creating conditions in which social outcomes (including patterns of activity) come about through certain kinds of processes. Sen often emphasizes individual choice as one of these processes. For example, a university's institutional structure answers to the process aspect of freedom by creating conditions in which students end up in certain classes and certain majors through their own choices rather than the choices of administrators or faculty members. In a very intuitive sense, a social arrangement would fail to answer to the value of freedom if it did not put students in control of their own educational activities.

The Kantian view shares Sen's general concern for the process aspect of freedom. From the Kantian point of view, a social arrangement answers to the value of freedom when it is structured in such a way that it is consistent with citizens respecting themselves and one another as free persons. An arrangement is consistent with mutual respect when it has a structure such that the processes that generate patterns of activity in society are properly sensitive to the practical judgments of citizens about these patterns. An arrangement is inconsistent with mutual respect when the processes that generate patterns of activity in society bypass the practical judgments of citizens about these patterns.

One difference between the two views is that the Kantian view stresses that there are cases where a social arrangement can answer to the value of freedom even if certain pattern-generating processes are not sensitive to the practical judgments of citizens. In certain situations, citizens are not in a position to organize on their own their activities in light of the relevant considerations. In these cases, a social arrangement can operate in such a way as to make up for the deficiency in citizens' rational capacities. But in order for the arrangement to be properly respectful in performing this task, it must generate patterns through a process that is reason sensitive, transparent, and trustworthy. An arrangement that operates in this way makes up for the deficiency in a respectful fashion and is therefore consistent with citizens respecting themselves and one another as free.

The new conception of the relationship between markets and freedom focuses on the pattern-maintaining character of an advanced market economy and the process aspect of freedom. The view does not deny that social arrangements also answer to the value of freedom by providing people with rights (see chapter 2) or valuable options to choose from—these measures may help to put citizens in a position to guide their activities in light of their own practical judgments. But an advanced market economy is not simply providing people with rights and options: it is also shaping their activities. Insofar as an advanced market economy is a mechanism of social control, the new conception says that the arrangement can be authoritarian if it bypasses people's judgments to determine their activities. And it can avoid being authoritarian if it acts as an extension of people's rational capacities and does so in a respectful fashion.

6.8. Summary

Let's go back one last time to the grocery store example that I started with in chapter 3. When you roam the aisles of the store, it is natural to think of freedom purely in terms of the various options that are open to you, i.e., options to buy one type of ice cream or another, one type of coffee or another. On my view, this is a genuine feature of the relationship between markets and freedom. But when you roam the aisles of the grocery store, it is essential to keep in mind that you are also playing a part in a powerful social coordination mechanism. The mechanism is drawing producers into certain patterns of production activity (e.g., making certain kinds of ice cream and getting these to the store shelves) and drawing consumers into certain patterns of consumption activity (e.g., eating more of certain types of ice cream and less of others). The constant shaping of people's activities involves social control, and the anti-authoritarian aspect of freedom demands that this control should be consistent with citizens respecting themselves and one another as free persons.

7

The Dynamical View of Business Corporations

In the previous four chapters, I developed a view about the relationship between markets and freedom. An advanced market economy is a social coordination mechanism: a way of getting ourselves organized to produce and consume things in a certain way. The mechanism is distinctive because it maintains a certain kind of society-wide pattern of production activity and consumption activity (i.e., a Pareto efficient pattern), and it does so through a process that bypasses the practical judgments of individual citizens about the merits of the pattern. Because it maintains a certain type of pattern through a judgment-bypassing process, the arrangement suffers from a potential moral defect—i.e., authoritarianism. An advanced market economy potentially violates the Kantian ideal of citizens respecting one another as free persons. To avoid the charge of authoritarianism, a market arrangement must be embedded in other institutions so that the social structure as a whole satisfies three requirements: reason sensitivity, transparency, and trustworthiness.

In this chapter, I want to develop the overall theory to address one of the most important economic institutions in the world today. Business corporations are powerful organizations in advanced market economies; they exercise important forms of social authority, and they are a powerful presence in our lives.[1] ExxonMobil, e.g., is a gigantic organization that commands the efforts of over 80,000 employees worldwide and controls assets worth over US$340 billion. These assets include refineries in 21 countries that together produce more than 3% of the global supply of oil. My main aim here will be to develop a basis for thinking about the proper internal

[1] My discussion in this chapter will focus on publicly traded business corporations. These profit-seeking organizations are defined under the law as having the following features: (a) legal personality, (b) limited liability, (c) transferable shares, (d) centralized management under a board structure, and (e) certain shared rights of control and financial gain assigned to capital investors (adapted from Armour, Hansmann, and Kraakmen 2009). Although I focus on the case of publicly traded business corporations, much of what I have to say could extend to other types of business enterprises—e.g., partnerships, limited liability companies.

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authority structure for business corporations such as ExxonMobil and the norms that should guide corporate officials in exercising their official powers.

In theorizing about "corporate governance," many philosophers, economists, and political theorists draw an analogy between the authority of the corporation and the authority of the state (e.g., Berle and Means 1932; Coase 1988b; Dahl 1985; McMahon 1994, 2013; Ciepley 2013; Anderson 2017). On this view, the corporation exercises authority over employees much like the state exercises authority over citizens, so the internal structure and norms for business corporations should incorporate protections for workers that parallel protections for citizens in liberal political constitutions. Though I agree that business corporations exercise a form of authority in society, the analogy with the state is misleading.

The chapter begins with some examples that stress the political character of the authority of business corporations. It then takes up the dominant view of the corporation in contemporary academic discourse—what I call *the economic theory of the corporation*. This view treats the authority of business corporations as if this authority could be justified purely in terms of economic efficiency. After addressing the economic view, I turn to a more explicitly political view of the corporation.

In a series of important works, Christopher McMahon (1994, 2013) draws a parallel between corporate authority and state authority. He argues that both forms of authority must be justified in terms of principles of legitimacy that apply to practical authority in the context of reasonable pluralism and moral disagreement. McMahon gets many things right, but his view implies an overly personal conception of subordination in an advanced market economy. Corporations—even giant corporations like ExxonMobil—come together and break apart as part of an ongoing process of market coordination that, under favorable conditions, maintains an economically efficient pattern of production and consumption in society. Though a particular corporate official may issue orders for employees to follow, this official is, to a significant degree, accidental; if the official does not enact a profit-making production plan, the market process will replace her with another official that will. Similarly, if a particular corporation does not enact a profit-making production plan, the market process will replace it with another corporation that will. Thinking of subordination in a market economy simply as subordination to particular corporate officials or particular corporations fails to acknowledge the deeper structure that lies behind these entities. The critique of McMahon's view—and the related view of Elizabeth Anderson (2017)—will lead to my own view, which regards the practical authority of business corporations as a functional element in a more complex mechanism of social control. It is this more complex mechanism that must live up to the Kantian ideal of mutual respect.

7.1. Thinking about the Authority of Business Corporations

When we think about business corporations, we typically assume a depoliticized view of these organizations. We situate the corporation in the context of the market, and we take it more or less for granted that market powers and the pursuit of profit are justified. Against this backdrop, the authority of business corporations over resources and employees seems like a straightforward exercise of market powers in the pursuit of profit, and as such it seems obviously to be justified.

In order to think clearly about the issues, however, it is important to separate the authority of business corporations, in the first instance, from the implicit justification. We should start instead with a more basic fact. One of the most striking things about social life in liberal market democracies today is that most citizens spend most of their waking hours following orders. In their work lives, citizens have superiors who tell them what to do, and for the most part, people do what they are told. Moreover, the directives citizens comply with at work often have an important political dimension: these directives bear on important social and political values. Now it may turn out that these features of the economic order in liberal market democracies *can* be justified as an exercise of market powers in the pursuit of profit. But in order to see whether this is true, we have to start by focusing on the basic fact of corporate authority.

To make the fact of corporate authority more concrete, consider the following stylized illustrations of what we see on a regular basis in liberal market democracies today.

> **Mountaintop Mining.** TOPOFF Inc. is beginning operations on a new coal mine in a pristine mountain valley in the Kentucky Appalachians. The company orders its employees to plant a million pounds of dynamite to blow the top off one of the mountains in order to gain access to the coal seam below. All the employees are citizens in the political community, each with

her own ideas about political values and ideals. Many employees disagree with the underlying mining activity on moral, political, or environmental grounds. But each employee sets aside her own views about the merits of the enterprise in order to carry out the company's orders.

Fossil Fuel. Excess Petroleum is engaged in a long-term project to develop various techniques to extract oil from arctic oil deposits. Extracting oil from these sources would greatly expand the sum total of fossil fuels available for global consumption and thereby worsen climate change. All employees of Excess Petroleum are citizens in the political community, each with her own ideas about political values and ideals. Many employees disagree with the new extraction proposal; among other things, they believe that the proposal would violate the obligation that citizens today owe to future generations. But each employee sets aside her own views about the merits of the extraction proposal in order to carry out the company's orders.

Airplane. SKIE Aviation is an aerospace company working on a new design for an existing commercial airplane. The plane is quite popular with airlines, and the company has many standing orders for the plane and expects many more orders in the future. The design of the plane incorporates many features that affect the fuel efficiency and overall safety of the aircraft. All employees of SKIE Aviation are citizens in the political community, each with her own ideas about political values and ideals. Many employees disagree with elements of the new design for the plane because of the trade-offs it makes between profitability, fuel efficiency, and overall safety. But each employee sets aside her own views about the design of the plane in order to build the plane according to the design adopted by the company.

Each of the three examples illustrates the de facto authority of business corporations.[2] In each of the three cases, we see that employees in a corporation are also citizens in a political community, who have a complex conception of political values and ideals. These values and ideals may tell in favor of

[2] Throughout my discussion, I will focus mainly on the authority of business corporations rather than corporate officials. If corporate officials exercise authority over employees, I take it that they exercise this authority in virtue of the fact that their official decisions determine how the corporation will exercise institutional powers accorded to the corporation by the law. The basic claims that I make in this chapter about the authority of business corporations can be extended to apply to the authority of corporate officials, understood as the individuals who occupy corporate offices and make decisions that determine how the corporation exercises its various institutional powers.

or against some pattern of production activity that the corporation directs them to engage in. But employees set aside their political values and ideals in order to follow the production plan adopted by the corporation.

I want to address a possible objection right at the start. Some readers might question whether business corporations in the three cases actually exercise *any* form of authority. After all, in each of these cases, if the employees disapprove of the production activity that the corporation directs them to engage in, they are always free to quit their jobs and do something else. As such, you might reasonably think that the corporation in each of these cases does not exercise any form of authority over its employees: it's the employees who decide to continue to take part in the production activities of the corporation on their own.

I will come back to this objection later. But for the purposes of situating the discussion in this chapter, it will help to think about the following comparison. Suppose that we are thinking about a certain government agency and the proper way to organize its internal authority structure. Here our thinking typically focuses on the ends that the agency is supposed to serve and the structure of command and deference that is necessary to achieve these ends. With respect, say, to the Department of Justice or the Department of Defense, we start by thinking about the ends that these agencies are supposed to serve in a liberal democracy, and then we think about the forms of command and deference that might be necessary to achieve these ends.

Importantly, employees of government agencies may be free to quit their jobs if they disagree with official directives. This is true of both employees at the Department of Justice and employees at the Department of Defense. The fact that employees can quit is morally important because this fact can play a role in determining what types of authority structures would be justified in government agencies and what types of punishment might be appropriate for insubordination. But the fact that employees can quit when they want *does not bear on the fundamental question of whether we should have a Department of Justice or a Department of Defense in the first place or what structure of command and deference is appropriate for these organizations*. In fact, the order of justification seems to go in the *opposite direction*: once you determine what the most basic justification is for having these organizations in society, the values involved may tell in favor of organizing the overall laws of employment, hiring, and firing in such a way as to ensure that these organizations are properly staffed to carry out their allotted functions.

The same basic line of reasoning applies with respect to the business corporation. Business corporations are an important feature of social life in liberal market democracies. In the best-case scenario, employees in these organizations are free to leave whenever they want. This fact is important, but it does not bear on the fundamental question: *Should we have business corporations in our society at all?* And what structure of command and deference should these organizations have?

The institutions of an advanced market economy incorporate a wide range of measures to encourage the formation of business corporations and to shape the internal structure of authority in these organizations. Among other things, corporate law defines a legal status for business corporations, defines limited liability, and defines other aspects of the corporate form, including a default structure for corporate governance. Employment law in countries such as the United States specifies that employees stand in a "master and servant" relationship with employers—i.e., employers have the right to command employees and employees have a duty to obey. Though it may be true that employees can leave a business corporation whenever they want, this fact does not provide a justification for a structure of corporate law, employment law, and other types of law that encourages the formation of business corporations and assigns them important legal powers. To justify these elements, we need a deeper account of why an institutional order should encourage the formation of organizations of this kind, why it should grant these organizations certain forms of authority, and what kind of internal structure these organizations should have.

7.2. The Economic Theory of the Corporation

By "the economic theory of the corporation," I mean a particular set of background normative assumptions that inform mainstream debates about corporate governance in economics, legal theory, and popular culture. These debates focus on questions like the following: Who should be in control of the corporation, executives or shareholders? How much discretion should executives have? And to what extent should corporate officials make decisions based exclusively on the interests of shareholders rather than a broader range of stakeholders? To understand the various elements of the economic theory, it helps to think about a basic question: Why do we need business corporations at all? What would be wrong with a market economy that lacks these organizations?

In "The Nature of the Firm," Ronald Coase (1988b) provides an answer that sets the stage for most of the contemporary discussion.[3] "Transaction costs" are various costs that prevent otherwise mutually beneficial exchanges in the open market from occurring. For example, suppose that I don't like proofreading my papers and there is a proofreader in Bangalore who would be willing to proofread my papers for a price that I would be willing to pay. The exchange between us would leave us both better off. Unfortunately, the exchange might not occur, given the way things are, because of the time and energy that it would take for me to find the proofreader and the time and energy that it would take the proofreader to find me. The costs of locating the counterparty are high enough to outweigh the benefit to either of us of the exchange. Some other examples of transaction costs include the costs of gathering information and the costs of negotiating contracts.

Coase's insight fundamentally shapes the economic theory of the corporation. We can think of the theory in terms of four basic claims:

1. The justifying rationale for a market economy is that, under ideal conditions, market coordination will maintain a society-wide pattern of production activity and consumption activity that is "economically efficient" or "socially optimal."[4]
2. Market arrangements in the real world operate under conditions that approximate the ideal conditions closely enough that market interaction maintains a society-wide pattern of production activity and consumption activity that is closer to the socially optimal pattern than the pattern under any realistic institutional alternative.

[3] I should note that Coase is interested in the more general question of why a market economy needs *firms*, whether corporations, partnerships, individual owners, or other entity. But the answer to the more general question also shapes how people think about the more specific case of a corporation.

[4] For the purposes of discussing the economic theory, I will use the following definitions. I will use the terms "economically efficient" and "socially optimal" interchangeably. What is economically efficient or socially optimal is an overall pattern of production activity and consumption activity in society. A pattern is economically efficient or socially optimal when it is the best feasible pattern (or a member of the set of unsurpassed patterns) as judged from the standpoint of a welfarist standard of assessment, such as aggregate welfare maximization, Kaldor-Hicks efficiency, or the Pareto criteria. One pattern of activity is intuitively "closer" to an economically efficient or socially optimal pattern when it is both feasible and would be judged superior in terms of the welfarist standard of assessment. An overall pattern of production activity and consumption activity is one part of a "social state of affairs," which is a complete set of possible facts about society, and we can equally speak of a social state of affairs as being "economically efficient" or "socially optimal."

3. The justifying rationale for business corporations (and firms more generally) is that these organizations make up for certain deficiencies in real-world conditions (e.g., transaction costs) that prevent market interaction from maintaining a society-wide pattern of economic activity that is socially optimal.
4. A corporate governance regime (i.e., an internal authority structure for corporations and set of norms for corporate decision-making) is justified when adherence to the regime would lead corporations and corporate officials to act in ways that make up for the deficiencies that prevent market coordination from actually maintaining a society-wide pattern of economic activity that is socially optimal.

Most economists who address corporate governance accept the basic features of the economic theory (e.g., Coase 1988b; Jensen 2001, 2002; Jensen and Meckling 1976; Williamson 1985; Fama 1980). These theorists hold that, from the standpoint of economic efficiency, various defects in real-world circumstances make alternatives to market coordination necessary and that a corporate governance regime should be designed to make up for these deficiencies.[5] The economic theory also informs the work of many legal theorists. Those in the "law and economics" movement, e.g., note that there are various deficiencies in real-world circumstances that prevent open market exchange from bringing about the socially optimal pattern of economic activity: transaction costs, costs associated with making complete contracts, agency costs, etc. They interpret the main features of corporate law as measures that address these deficiencies and help market interaction to bring about a socially optimal pattern (e.g., Easterbrook and Fischel 1991; Hansman 1996; Klein and Coffee 2004).

It is worth noting that theorists who share the assumptions of the economic theory sometimes disagree about substantive questions of corporate

[5] One important complication has to do with agency theory. Theorists such as Jensen and Meckling (1976) are interested in how the internal structure of a business corporation can be understood as the outcome of a hypothetical market exchange process among the various parties that contribute to the corporation's activities—creditors, suppliers, employees, etc. This strand of economic theory builds on Coase's view by developing an account of why firms have certain internal structures, such as a structure in which managers are answerable to shareholders rather than employees. This account appeals to a general idea of economic efficiency (i.e., Kaldor Hicks efficiency) in that assumes that certain costs (e.g., agency costs) should be distributed in an efficient way. But this account differs from other accounts in the literature in that it does not justify a certain internal structure for business corporations in terms of how this structure would address a failing that would prevent the open market exchange process from bringing about a socially optimal state. (Similar arguments appear in Easterbrook and Fischel 1991 and Hansmann 1996).

governance. Michael Jensen (2001, 2002), e.g., accepts the economic theory and argues for "shareholder value theory." He suggests that the proper internal authority structure for business corporations and the proper norms for business decision-making are those that would maximize returns for shareholders over the long run.[6] As Jensen (2002, 239; see Hussain 2012a) puts it, "200 years' worth of work in economics and finance indicate that social welfare is maximized when all firms in [a market] economy maximize total firm value."[7]

Other theorists accept the economic theory but reject the focus on shareholder value. Margaret Blair and Lynn Stout (1999; Stout 2012) argue that some socially beneficial forms of production are instances of "joint production," i.e., production where the contribution of each participant to the final product is not easily separable. Think of John Lennon and Paul McCartney writing great songs together, where it is very hard to tell who contributed what to each song. Rationally self-interested actors will be reluctant to invest time and resources in joint production when they are not confident that they will receive an adequate share of the surplus their investment creates or when they believe that other participants may freeride on their contributions. Publicly traded corporations can make up for the problem by creating a "mediating hierarchy": an institutional mechanism that can act as an impartial arbitrator, giving assurance to each participant in joint production that she will receive adequate compensation for her investment and that other parties will not shirk their responsibilities. But publicly traded corporations cannot serve this function effectively if their internal governance processes

[6] Keep in mind that, on Jensen's view, maximizing shareholder value may not be a norm of corporate decision-making. It may turn out that shareholder returns are highest when managers seek to balance the interest of various stakeholders rather than maximize the returns to shareholders. If this is the case, Jensen's view implies that the correct norms of decision-making require managers to balance the interests of various stakeholders.

[7] Jensen's argument for shareholder value theory relies implicitly on a version of the "efficient markets hypothesis" (see Hussain 2012). The idea is that participants in the financial market collectively form a kind of information-processing system that synthesizes all public information that bears on the profitability of particular corporations, including information about the wider economic environment. The judgments that result are expressed in the evolving prices for shares in a particular corporation (Fama 1980; Sunstein 2008; cf. Shiller 2006). Although the judgments expressed in share prices can be mistaken, there is no individual or group in society that can offer more reliable judgments about profitability. As evidence of the epistemic superiority of financial markets, proponents of the "efficient market hypothesis" point to the fact that no investor has been able to fashion a portfolio of investments that earns greater returns over the long run than a randomly selected portfolio of equivalent size—i.e., no one can "beat the market."

are designed merely to maximize returns for one of the parties in joint production—i.e., shareholders.[8]

7.2.1. Does Economic Efficiency Justify a Structure of Corporate Authority?

For my purposes, the most important question the economic theory raises is a question about authority. Implicit in the economic theory is an account of the justification of authority. According to this account, an authority structure—i.e., a structure of command and deference—is justified when it serves the aims of economic efficiency: the overall pattern of production activity and consumption activity in society is closer to the socially optimal pattern when the authority structure is in place as compared to when it is not. In the usual case, the society-wide pattern is closer to the social optimum because the authority structure compensates for failures in social circumstances that prevent market coordination from generating the optimal pattern.

Consider the Boeing Company, a giant corporation that has authority over 158,000 employees and a vast array of productive assets. According to the economic theory, under ideal conditions, coordination through open market exchange could draw Boeing workers and Boeing assets into an economically efficient pattern of production activity on its own—there would be no need for the Boeing Company and its corporate authority structure. But as a matter of fact, various deficiencies in social circumstances (e.g., transaction costs) would prevent open market exchange from organizing these workers and assets into the right pattern. The authority structure in the Boeing corporation—i.e., its fiat authority over both employees and assets—is

[8] Jensen might argue that Blair and Stout's view is compatible with what he calls "enlightened shareholder value theory" (see Jensen 2002; note 6 in this chapter). If a mediating hierarchy would generate greater firm-specific investment, then this corporate form would presumably increase profits and thereby serve to maximize shareholder value in the long run.

The problem with the compatibility argument is that it ignores distributive concerns. It is plausible that in some cases, certain policies (e.g., reducing wages) could have little effect on firm output and thereby have little effect on the firm's net income. But these policies might increase returns for shareholders because the residual that remains as profit after all fixed claims (e.g., wages) have been paid is larger—in effect, these policies move some of the surplus created in the firm from workers to shareholders. If policies such as these exist, then enlightened shareholder value theory would say that corporate governance should be designed to pursue them. But the mediating hierarchy view would not necessarily have the same implication because the mediating hierarchy view requires that the corporate structure should treat each of the groups contributing to the firm fairly.

justified insofar as the corporation plays its part in organizing these resources into an economically efficient pattern of activity.

The economic theory represents one example of a familiar, consequentialist approach to the justification of authority: it appeals fundamentally to the good consequences that result when we adopt a certain authority structure. I want to draw attention to two basic problems with the economic theory, both of which stem from the fact that an authority structure is not morally justified simply in virtue of the fact that it brings about a more efficient pattern of production and consumption in society.

The first problem has to do with the narrowness of economic efficiency. When it comes to the justification of a society-wide pattern of production activity and consumption activity, what matters is not simply that the pattern is economically efficient, but that it satisfies a range of values and ideals that go beyond efficiency. What matters is that the pattern is *comprehensively reasonable*. For example, a society-wide pattern may be economically efficient, but it may nonetheless be unjustified because it violates the standards of distributive justice. Here is an illustration. Imagine a society-wide pattern of production activity and consumption activity in which one group in society ("serfs") carry all of the burdens in production, while another group in society ("lords") enjoy all of the benefits in consumption. This pattern might be economically efficient in the sense that it is Pareto optimal—i.e., there might be no feasible way to alter the pattern to improve the condition of any serf without taking some benefit (however marginal) from a lord. But even if the pattern is economically efficient, it is unjustified because it violates the requirements of distributive justice—it is completely unfair to the serfs. As such, it does not count in favor of an authority structure that it helps to bring about a pattern of economic activity of this kind.

When it comes to justifying an authority structure in economic life, the distributive character of the pattern of production activity and consumption activity generated by the structure matters—not just its efficiency. In the case of Boeing, an attractive feature of putting certain decision-making powers in the hands of the Boeing company and its officials is that these actors will respond to price signals and use this authority to organize workers into socially beneficial patterns of production activity. At the same time, however, it is important to consider how the authority structure would affect society-wide patterns of consumption. It counts *against* the authority structure at Boeing that it may contribute to inequality in consumption. With significant institutional powers in the boardroom and privileged access to information, Boeing managers can extract a greater share of the surplus created by production activity at Boeing in the form of large salaries, stock options, golden parachutes, corporate retreats, private jets, etc. Aggregated across the economy (and across the globe), the authority structure that empowers corporations and corporate officials to organize economic activity in the corporation may contribute significantly to economic inequality (see Piketty 2014).

Whether the authority structure at Boeing (or any other corporation) is morally justified is not just a matter of economic efficiency but also a matter of how the assignment relates to other social values. I have stressed distributive justice because this is the most obvious illustration. But a wide range of other values bears on the choice of a pattern of production activity and consumption activity, including respect for privacy, respect for human rights, and respect for the environment. All of these values bear on the justification of an authority structure.

The second aspect of the justification of authority that is missing from the economic theory has to do with the Kantian ideal of mutual respect (see chapter 4). Workers and consumers are not just disconnected market actors; they are also citizens in a political community. They each have a fully realized capacity for practical judgment and a conception of various social and political values (see McMahon 1994 and below). A framework of social and political institutions for a liberal democracy must satisfy the ideal of mutual respect: the arrangement must be structured in such a way that in complying with the rules, citizens respect themselves and one another as free persons, each entitled to govern her life according to her own capacity for judgment.

On my view, the ideal of mutual respect allows for an institutional framework to incorporate a structure of authority and deference, but it can do so only in cases where the structure makes up for deficiencies in the rational capacities of citizens to organize themselves in a rational fashion without the mediation of the authority structure. Moreover, when an institutional order creates an authority structure for these coordinating purposes, the order must bypass the rational capacities of citizens in a way that is still respectful of their capacity for judgment. An essential requirement here is transparency: when an arrangement creates an office with practical authority attached, it must require the officeholder to explain and justify her decisions to the individuals whose activities will be guided by the decision. That is, the officeholder must explain the pattern of activity that citizens are being drawn into and the reasons that justify this pattern.

Return again to the case of Boeing. The production of the 787 Dreamliner is not just a narrowly financial decision but a decision that involves an array of social and political values. Most obviously, many features of the design of the 787 have implications for climate change—e.g., the fuel efficiency of the aircraft and the emissions standards that it lives up to. These design features are all the more important because Boeing is one of a very small number of airplane manufacturers in the world and because the 787 is popular among carriers. Each employee at Boeing is at the same time a citizen who has views about the importance of climate change and the responsibilities that companies have in addressing the problem. When Boeing makes a final decision on the design of the Dreamliner, it exercises a form of practical authority over its employees: it tells them to make the Dreamliner as designed, and the structure of command and deference in society requires employees to defer to corporate directives, regardless of their personal views about the correct trade-offs among the values involved.

According to the Kantian ideal of mutual respect, an institutional arrangement that incorporates a form of authority of this kind *can* be justified. It can be justified in those cases where the corporation is in a position to draw citizens into a valuable pattern of cooperation that they themselves have reason to enter into, where citizens would not be able to draw themselves into the pattern on their own—e.g., perhaps citizens lack the relevant expertise in aerospace engineering or a detailed understanding of consumer preferences. But in these cases, the institutional order must do more than simply draw citizens into an attractive pattern of production activity. The corporate structure must also satisfy the requirements of transparency; i.e., the corporation must explain to its employees what the pattern of production activity is that it is drawing them into and why this pattern is justified. In the case of Boeing, the transparency requirement would involve Boeing officials explaining the design of the aircraft, laying out the various trade-offs between different values involved (e.g., profitability, fuel efficiency, safety), and justifying the trade-offs that the company makes. It would be disrespectful to allow officeholders simply to draw citizens into the right patterns, without offering them any basis for understanding why these patterns in their work lives are justified.

7.3. The Functionalist View of Markets and Politics

Some readers might defend the economic theory of the corporation in the following way. Comprehensive reasonableness and mutual respect are both important in the justification of practical authority, but some readers might argue that there is an institutional division of society. Some values are supposed to be addressed by our economic institutions, while others are supposed to be addressed by our political institutions. For example, a liberal democratic order may incorporate an advanced market economy and business corporations to maintain a pattern of production activity and consumption activity that is economically efficient. Other values, such as distributive justice, may also be important, but it is the function of the *democratic political process* to generate laws and regulations that adjust market rules and market outcomes in order to ensure that the overall pattern of production activity and consumption activity in society answers to these other values. So we might agree with the economic theory that corporate authority is justified in terms of economic efficiency, as long as we keep in mind that it is the role of the regulatory process and the legislative process to ensure that economic activity in society is sensitive to other normative concerns.

The defense of the economic theory just offered appeals to what I call *the functionalist view of liberal democracy* (see chapter 6). The problem, as I argued in chapter 6, is that this view is completely unrealistic. A division of labor that requires the legislative and regulatory process to take responsibility for all other values besides economic efficiency makes demands on these institutions that they could never meet. Market activity is too wide-ranging, too dense, and too complicated for any centralized political and regulatory process to address changes in market activity in real time. As we have seen, the most important considerations are the following:

(a) *Epistemic limitations*: In a large, contemporary liberal democracy, market activity is so spread out and involves such a wide range of activities that it is extremely difficult for political officials (or anyone else) to centralize the relevant information and figure out what to do in real time (e.g., identifying systemic risks in financial markets as they arise).

(b) *Anarchic innovation*: Market actors are constantly innovating, intentionally or unintentionally, in ways that go beyond the scope of the existing regulatory framework (e.g., Uber and Lyft).

(c) *Obstacles to political mobilization*: It is extremely difficult for people to come together in a mass democracy to form a legislative coalition that can deal with complicated social problems (e.g., reforming the tax code to address new forms of executive compensation).

(d) "*Genie in a bottle*": With respect to certain technologies (e.g., genetically modified grains), once the technologies have been implemented, it is extremely difficult for laws and regulations to deal with the cascading social ramifications after the fact.

If market actors and market institutions were exclusively directed at realizing economic efficiency, the regulatory, surveillance, and enforcement effort necessary to address all of the various concerns that would arise would be beyond the capacity of any centralized political process. Most any plausible view about the institutional division of labor in a liberal democracy must assign some significant responsibility for addressing normative concerns beyond efficiency to nongovernmental actors, nongovernmental organizations, and various institutional structures in the civil sphere.[9]

7.3.1. A Spot Market for Labor?

Some readers might object to my argument in a different way. Some might argue that there is nothing special here that has to be justified: there is no authority relation between the corporation and its employees because all you have in these organizations is an ongoing "spot market" for labor. Imagine that a corporation posts a list of tasks every morning on eBay, along with a set of prices that it would be willing to pay anyone who shows up to perform these tasks. Some might argue that employment in an advanced market economy (particularly "employment at will") is like this: employees are like workers who just show up each morning at the office to perform certain tasks at the rate that the corporation posts. If employment is properly understood in this way, then it might be reasonable to deny that the corporation exercises anything like practical authority over employees. In fact, there is no "employment relation" at all.

[9] Think of the professional standards that apply to accountants, lawyers, financial advisors, journalists, etc. These are all examples of "governance functions" that are partly the responsibility of nongovernmental actors. Compare also Habermas (1989, 1996), who takes a much more "hands-off" approach to market governance.

Although the "spot market" conception of employment is common, it is at odds with the reality in large parts of economic life in liberal democracies today. Consider that corporations such as Boeing issue directives to employees in the context of very long-term production projects, like the 15-year project of designing and building the 787. Boeing formulates and carries out these production projects in the context of an even more fundamental and longer-term commitment to maintaining a portfolio of profitable production projects and continuously adapting this portfolio to changing market conditions in order to maximize financial returns for the indefinite future. Issuing directives within this framework of long-term commitments, corporations take a variety of measures to gain control over their employees and maintain this control over long periods of time. Some common measures include noncompete clauses, promises of future promotions, stock options, pension plans that vest in the future, and measures that require firm-specific investments (e.g., learning a complex proprietary software package). Business corporations regularly seek to develop and reinforce ongoing, long-term relationships with employees, and this pattern of activity, though not universal, is both widespread and inconsistent with the "spot market" model of nonrelational employment.

A more fundamental problem with the "spot market" model, however, is that it is inconsistent with the idea that lies at the foundation of the economic theory of the corporation. Recall that on Coase's view, market coordination is *defective* from the standpoint of efficiency because transaction costs would prevent open market exchange from bringing certain socially beneficial patterns of production activity into existence. The defect would exist, I take it, in a world in which employment is organized simply through an ongoing "spot market" for labor: in this world, market actors would have to identify a new set of counterparties every day, negotiate a new set of contracts, etc. What is needed, according to Coase, is an *alternative* to market coordination: fiat authority, i.e., an employment relationship. We need an employment relationship of some kind in order to bring attractive patterns of production activity into existence, bypassing the inefficiencies of a market plagued with transaction costs. It follows that the economic theory of the corporation would get no support from a "spot market" view of employment that simply denies the existence of an employment relationship.

Let me reiterate that the authority structure inherent in employment is clearly recognized in the law (at least in the United States). According to the *Restatement of the Law of Agency* (2006), "An employee is an agent whose principal controls or has the right to control the manner and means of the agent's performance at work" (§ 7.07). Moreover, as McMahon emphasizes, some form of authority over the employee is essential to the work process. Boeing has private ownership and control over various productive assets, such as hangars, workshops, computer equipment, and machine tools; the company can allow workers access to these assets and can deny them access. But control over material assets alone is not sufficient to build a 787 Dreamliner. At some point, in order to build the plane, workers have to actually *do* what the company tells them to do. So again, some form of authority over employees is essential to the corporation.[10]

7.4. A Political Theory of Business Corporations: Christopher McMahon

Among contemporary political philosophers, Christopher McMahon (1994, 2013) offers the most sophisticated treatment of the authority of business corporations. Unlike the economic theory, McMahon's (2013; see also 1994, 169–85) theory incorporates a wide range of social values besides efficiency, including distributive justice, civil liberty, public health, environmental preservation, and the advancement of knowledge. On his view, the justification for institutional structures in economic life may involve technocratic arguments that appeal to economic efficiency, but they may also involve political arguments that appeal to a wider array of values.

With respect to the justification of corporate authority, McMahon draws a distinction between *de facto* authority and *de jure* (i.e., legitimate) authority. *De facto* authority involves a complex set of facts about how people think and act (see McMahon 1994, 25–33; Raz 1986).[11] A *de facto* authority relation exists between *A* and *B* when:

1. *A* has the power to make *B* do x by telling *B* to do x;
2. *B*'s conduct is not guided by *B*'s own assessment of the underlying (i.e., directive-independent) reasons for doing x, but by A's assessment of these reasons; and

[10] Note that workers are not typically recognized in the law as having authority over the corporation they work for in the same way that the corporation has authority over them. Authority relations are asymmetrical in a way that contractual and other market relations are not.

[11] Unless I specify otherwise, I use the term "authority" and "authority relations" to refer to *de facto* authority rather than *de jure* or legitimate authority. See (McMahon 1994, 26–7).

3. *B* treats *A*'s directive as a "preemptive" reason for action; i.e., *B* treats the fact that *A* tells her to do x as a reason both to do x and not to act on her own assessment of the underlying reasons for doing x.

Suppose, for example that there is a doctor in a neighborhood. If the doctor tells people in the neighborhood to take a certain pill, they will take it. Moreover, people generally treat the fact that the doctor tells them to take the pill as a reason both to take the pill and not to act on their own assessment of the reasons for or against taking the pill. So, in effect, their conduct is guided by the doctor's assessment of the reasons for or against taking the pill rather than their own assessment. In this case, there is a *de facto* authority relation between the doctor and the people in the neighborhood. Keep in mind that it is a further question whether people in the neighborhood have good reason to treat the doctor's directives as preemptive reasons for action—i.e., *de facto* authority may not be *de jure*.

De facto authority relations are a central feature of business corporations in advanced market economies (see McMahon 1994, 15–9; Ciepley 2013). What we find in these economic orders is that corporations enjoy a position in social life that is analogous to the position of the neighborhood doctor. In the case of Boeing, the corporation can issue directives to its employees, and its employees will treat these directives as grounds both for complying with the directive and for setting aside their own judgment about the underlying reasons for performing the relevant actions. For example, Boeing can direct its employees to perform the various actions involved in assembling a 787 Dreamliner. When employees carry out these directives, they will treat the fact that the corporation tells them to build the plane as a reason both to build the plane and not to act on their own assessment of the underlying reasons for building it (as opposed, say, to some other type of plane). When employees carry out these directives, their conduct will be guided by Boeing's determination that employees should build the 787 rather than the employees' own determinations.

Part of what makes *de facto* authority morally important in the context of the business corporation is that *de facto* authority here often involves *moral subordination*. McMahon (1994, 191–3) rightly sees market actors as being interested in more than just earning an income and satisfying their consumer preferences. Market actors are also citizens, who have (at least a general) a conception of the public good, a conception of fairness, and a conception of the proper division of labor between various institutions and organizations in society. Moral subordination occurs when an agent guides her conduct not according to her own moral judgment but according to some other moral judgment that is not her own. Business corporations have *de facto* authority over employees, and since production activity often involves moral and political values, corporate authority typically involves some degree of moral subordination among employees. From the moral point of view, the preemption of an agent's moral judgment seems to call for special justification.

According to McMahon, the *de facto* authority of business corporations can be *de jure*—i.e., legitimate authority—*even* when it involves moral subordination. Employees may have good reason to set aside their own assessments of the underlying reasons for a certain pattern of production activity and act according to the assessments of the corporation they work for. But in order for the *de facto* authority to be *de jure*, the authority must meet two basic conditions.

First, corporate authority must facilitate cooperation for the public good (McMahon 1994, 2013). Citizens have reasons to engage in various forms of production activity; e.g., citizens may have good reason to produce a fuel-efficient plane so as to transport people from one place to another in a cost-effective and environmentally sound fashion. But even if citizens have reason to produce a fuel-efficient plane and they all recognize this fact, they may have different views about exactly what kind of plane to produce, what materials to use, who should perform which tasks, etc. In order to carry out any production activity effectively, they need to all be working from the same plan, so in order to act on the reasons they have for engaging in a certain form of production activity, citizens need a coordinating authority to select an official plan for them to follow. If the corporation is in a position to choose an adequate plan for production activity, citizen-employees would find that they have good reason to comply with corporate directives and to set aside their own assessments of the underlying reasons for or against various production plans. Their conduct answers better to their reasons for engaging in certain forms of production activity when they set aside their own judgments and direct their conduct according to the practical judgment of the corporation.

Second, corporate authority must be structured in such a way that citizens have adequate reason to accept the ideological concessions involved in adopting a shared plan for production (see especially McMahon 2013). In the case of the 787 Dreamliner, Boeing employees may have different ideological views about the right trade-off between environmental concerns, profitability, and safety. So in selecting any shared plan for what type of plane to build, employees will have to make ideological concessions: they will have to accept certain departures from their own views about how these trade-offs should be made. McMahon thinks that citizens can have good reason to accept ideological concessions, but only in the context of institutional structures such as protections for the basic liberties, democratic participation, and voting mechanisms. It follows that these institutional structures must be incorporated into the structure of business corporations in order for the *de facto* authority of these organizations to be justified. In *Public Capitalism*, McMahon (2013) argues that the most obvious way to accomplish this is for corporations to treat the laws and regulations generated through the formal democratic political process as establishing a general framework within which to formulate production plans.

On McMahon's view, then, the political process and the regulatory process define the most general framework within which social life will unfold. Business corporations operate as "subordinate centers for coordination" in society. These agencies take laws and regulations as given, and within this framework they use their *de facto* authority to draw citizens into rational patterns of production activity that citizens have independent reasons to engage in. The authority of business is legitimate because some such coordinating authority is necessary in social life and citizens have reason to accept the ideological concessions involved, given that appropriate protections for civil liberties and appropriate forms of democratic participation are in place.

7.5. What Role Do Particular Corporations and Officials Play in Moral Subordination?

On McMahon's view, the authority relation in a corporation is a relation that holds between the employees of the corporation, on the one hand, and the corporation (and its officials), on the other. In the context of the corporation, the conduct of employees is guided by the moral judgment of the corporation (and its officials) rather than their own moral judgments, so employees are morally subordinated. But is it right to think of the moral subordination of employees in such personal terms?

To examine the issue, consider again the case of Darren Woods, CEO of ExxonMobil. Along with a small cadre of executives and board members, Woods commands the efforts of over 80,000 employees worldwide. These employees stand in a *de facto* authority relation with Woods and with ExxonMobil, and this relation involves a form of moral subordination, as employees set aside their own views about climate change or the rights of Indigenous people in order to carry out company directives. Here it seems that the moral subordination of employees consists in the fact that their conduct is guided by the moral judgment of Darren Woods and ExxonMobil.

But to see how important particular agents such as Woods are, imagine that one day Woods forms the following judgment: "Fossil fuels are a ticking time bomb that will destroy humanity." Given that he forms the judgment, what can he do?

I take it that Woods has three basic options:

Option 1: Follow your moral judgment and get fired

If Woods forms the moral judgment about fossil fuels, he could direct ExxonMobil employees to act in ways that are consistent with his judgment. This might involve raising gas prices at ExxonMobil gas stations in order to finance a more responsible environmental strategy aimed at weaning society off fossil fuels in the long run. Assuming that consumers are mainly price-sensitive at the pump, however, when employees carry out Woods's directives, ExxonMobil will slowly start losing market share to its competitors. Declining sales will lead to financial losses. And these losses will eventually lead to Woods getting removed from office; there might be a vote by the board of directors, a shareholder revolt, or a hostile takeover. Once he is removed, someone else will move into Woods's position, someone more likely to hold a moral judgment that is consistent with answering to consumer preferences, making profits, and drawing people into a pattern of production activity and consumption activity that is economically efficient.

Option 2: Follow your judgment and face bankruptcy

If Woods forms the moral judgment about fossil fuels, he could direct ExxonMobil to pursue an environmental strategy that leads to price increases and declining market share. When the inevitable revolt comes, he could stick to his guns: he could fight the board, fight the shareholders, fight the hostile takeover. Eventually, however, the financial losses will pile up. Creditors will come asking for repayment, and ExxonMobil will go bankrupt. Bankruptcy would disperse the company's assets to other firms, where these other firms are guided by moral judgments more consistent

> with answering to consumer preferences, making profits, and drawing society into a pattern of production activity and consumption activity that is economically efficient.
>
> *Option 3: Suppress your own moral judgment*
>
> If Woods forms the moral judgment about fossil fuels, he could elect not to commit career suicide. He could stay in his current position at ExxonMobil and simply set aside his own moral judgment. Instead of allowing his own moral judgment to guide his conduct, he would direct his conduct according to a moral judgment that is compatible with answering to consumer preferences, making a profit, and drawing society into a pattern of production activity and consumption activity that is economically efficient.

In all three cases, the moral subordination of employees remains: the conduct of employees is guided by a moral judgment that licenses the use of fossil fuels.

Thinking about the situation of agents such as Woods shows that it is a mistake to think of the moral subordination of employees in terms of their subordination to *particular actors*. When you take a snapshot view of the corporation, it may seem that the moral judgment that guides the conduct of employees is a moral judgment that emanates from a particular corporate official (e.g., Darren Woods) and a particular corporation (e.g., ExxonMobil). But when you situate the corporation and its employees in an ongoing process of market competition, you can see that the moral judgment does not emanate *simply* from these actors.

Market competition continuously favors corporations and corporate officials who act according to certain moral judgments. It may be true that Woods issues certain directives to ExxonMobil employees. But if he disagreed with the exploitation of fossil fuels, the market process would replace him with an executive who holds the pro–fossil fuel position. The process could also replace ExxonMobil with another corporation that operates according to the pro–fossil fuel position. The moral judgment that is in a position to direct the conduct of employees would have a certain character, regardless of the involvement of specific actors such as Woods or ExxonMobil. The market process operates in the background to help ensure that the controlling judgment in the lives of employees is one that is compatible with an economically efficient pattern of production and consumption in society.

A related problem is that McMahon's view obscures the full extent of moral subordination in an advanced market economy. On McMahon's view, the moral subordination of employees consists in the fact that the moral judgment that directs their conduct is the moral judgment of the corporation and its corporate officials. But this personalized view of moral subordination obscures the fact that *corporate officials themselves (and even corporations) may be morally subordinated to a significant degree in an advanced market economy*. Corporations and corporate officials act in a competitive market environment, and the impersonal process of market coordination can force them to act according to moral judgments that are at odds with their own moral judgments. It is quite common to find executives in the position of Darren Woods who hold that fossil fuels are a ticking time bomb but set aside their own moral judgments to act according to a judgment that serves the company's financial interests. Moreover, many corporations in the position of ExxonMobil may (in some sense) hold moral judgments that oppose the use of fossil fuels, but they may organize their activities according to a pro–fossil fuel judgment regardless.

The basic point is that if the moral concern raised by corporate authority has to do with moral subordination, then we cannot limit our attention to the authority relation that ties workers to specific corporations and specific corporate officials. Standing behind all of these particular actors is an *impersonal* process of social coordination that works through market competition. The impersonal process continuously favors corporations and corporate officials who hold (or act as if they hold) moral judgments that are compatible with an economically efficient pattern of production and consumption. Moral subordination in an advanced market economy is not simply a matter of the subjection of employees to a particular corporation or a particular set of corporate officials. It is also substantially a matter of this impersonal process. The proper object of moral concern for those who care about moral subordination should encompass not only authority relations in the corporation but also the wider market process within which these corporations operate.

Let me add two clarifications. First, no market arrangement works perfectly, and there is always some slack in the system. Corporate officials are not automatically replaced when they make decisions that are inconsistent with efficiency, and inefficient corporations do not dissolve overnight. This means that the decisions of particular corporations and particular corporate officials can play an important role in shaping the lives of employees. This is why, on my view, the proper object of moral concern is an institutional arrangement that encompasses *both* the practical authority of business corporations (and corporate officials) *and* the wider market process.

Second, I am not arguing that McMahon has misidentified the agent who exercises authority in an advanced market economy: I am not arguing that the consumer exercises authority, or that the market exercises authority, or that the invisible hand does, or capital does. What I am arguing is that if you believe that the authority of corporations and corporate officials is morally problematic and you believe that it is morally problematic for the most obvious reason—i.e., the moral subordination of human beings—then the proper object of your moral concern should actually encompass not only these corporate authority relations but also the impersonal process of coordination that substantially determines how corporations operate. There is a widespread tendency in our political culture today to heap criticism on corporations and corporate executives without taking the next logical step. The reasons that move us to be morally concerned about the authority of corporations and corporate executives should move us also to be concerned about the impersonal process of market coordination. But in a wide range of academic and nonacademic discourse, you will find that people criticize the corporation and corporate officials without objecting to the market process that conditions how these agencies operate. It is misguided to direct so much criticism at the snowflakes without asking where the blizzard came from.

7.6. A Better Way of Thinking about Business Corporations: The Dynamical View

I will now formulate a way of thinking about the authority of business corporations that overcomes the limitations of the two theories I considered. In order to formulate the new approach, it will help to review in a schematic way some key features of the overall account of the relationship between markets and freedom that I developed in earlier chapters.

7.6.1. Institutions Are Objective Rule Structures

A social institution is an impersonal scheme of rules (and sometimes principles) that specifies how the members of an association should think and act, where each member of the association has an obligation to adhere to the scheme in part because the other members are adhering to it as well. Advanced market economies are social institutions in this sense. These arrangements consist of a complex system of rules, including rules that define private ownership, exchange, competitive markets, and the corporate form, as well as underlying principles that specify the justifying aim of these rules. Citizens in liberal market societies each have reason to adhere to the rules (and underlying principles) in part because other citizens are adhering to them as well.

7.6.2. The Moral Status of an Institution Is Primarily a Matter of Its Rule Structure

Social institutions have certain moral properties in virtue of the structure of their rules. These moral properties may factor in various ways in determining the moral duties of individual citizens. For example, the institutional order in a certain society may be unjust because it violates the structural requirements of Rawls's first principle of justice: the rules do not define a fully adequate scheme of equal basic liberties for all citizens. The unjust character of the institutional order will then determine a range of individual duties for citizens—e.g., a duty to reform the institution, a duty to vote for changes to the rules, a duty to be civilly disobedient.

7.6.3. Some Social Institutions Are Judgment-Bypassing Coordination Mechanisms

A coordination mechanism is an institution where the rules are understood to be justified insofar as they maintain some pattern of activity R among the members of an association—e.g., a traffic code is publicly understood to be justified insofar as it maintains a safe pattern of movement on the roads.

Some coordination mechanisms maintain a pattern of activity R among the members of an association but do so in a way that bypasses the private judgments of members about the merits of R. Suppose that, as a matter of fact, a group of high school kids playing a decently competitive soccer match will get a certain amount of exercise over the course of an hour. A high school gym class may incorporate the rules of a soccer match, where the rules are understood to be justified insofar as they ensure that students get the right amount of exercise. The rule structure will maintain the relevant pattern in the activities of students (i.e., their getting a certain amount of exercise) independent of the practical judgments that the students may form about the merits of the pattern.

7.6.4. Judgment-Bypassing Social Coordination Mechanisms Are Potentially Authoritarian

Authoritarianism is a particular moral defect in a social coordination mechanism. It is a structural defect, much like injustice, and it parallels the moral wrong displayed by governments that are unresponsive to the practical judgments of their citizens. If a social coordination mechanism maintains a certain pattern of activity R among the members of an association and it does so in a way that bypasses the practical judgments of members about R, then the mechanism may be authoritarian. When everyone adheres to the scheme, they may fail to respect themselves and one another as free persons, each entitled to govern their conduct in light of their own practical judgments. The arrangement may violate the Kantian ideal of mutual respect.

7.6.5. Judgment-Bypassing Social Coordination Mechanisms Can Be Justified When They Satisfy Three Requirements

There is at least one kind of case in which a judgment-bypassing social coordination mechanism can be consistent with the Kantian ideal of mutual respect. This is the case where members of an association have good reason to R, but they are not in a position to draw themselves into the pattern R on their own. For example, in a city with millions of people, drivers have good reason to drive in a safe and efficient pattern on the roads, but it is impossible for millions of drivers to communicate with each other and efficiently coordinate their driving activity on their own. A system of traffic lights may then serve to draw everyone into a safe and efficient pattern of traffic activity, even though the lights continuously maintain the pattern in a way that bypasses the private judgments of individual drivers about the merits of a specific pattern.

In the case where a judgment-bypassing coordination mechanism makes up for some deficiency in the rational capacity of members of an association to coordinate their activities on their own, the mechanism must still perform this function in a way that is properly respectful of the rational capacities of citizens: (1) The mechanism must be *reason-sensitive*: it must draw members into the pattern that they have most reason to take part in. (2) The mechanism must be *transparent*: it must make clear to members (to the extent this is possible) what pattern it is drawing them into and the reasons that justify this pattern. (3) The mechanism must be *trustworthy*: when it is operating in ways that are not transparent, it must give members good reason to believe that it is nonetheless drawing them into a rational pattern of activity.

When a judgment-bypassing coordination mechanism makes up for a deficiency in the rational capacities of citizens to coordinate their own activities, and it satisfies the three requirements, the arrangement is judgment-bypassing but not authoritarian. The arrangement does not violate the Kantian ideal of mutual respect.

7.6.6. An Advanced Market Economy Is a Judgment-Bypassing Coordination Mechanism

An advanced market economy is a complex rule structure that maintains a certain pattern R in the activities of citizens—i.e., a society-wide pattern of production activity and consumption activity that is economically efficient. The rules of the arrangement are publicly understood to be justified insofar as they maintain an economically efficient pattern. And the structure maintains an economically efficient pattern of activity through a process that bypasses the private judgments of individual citizens about the merits of the pattern. Because an advanced market economy maintains a certain pattern R in our activities in a way that bypasses our private judgments about R, it is potentially authoritarian.

7.6.7. The Various Rules That Define the Corporate Form Are Also Part of the Same Judgment-Bypassing Coordination Mechanism

The institutional rules of an advanced market economy define the business corporation, assign it a certain status, assign it various institutional powers, define how these organizations come into existence and pass out of existence, etc. The point of these rules is to create organizations that serve in various ways to help the market coordination process to maintain an economically efficient pattern of production and consumption in society. Since the overall market process maintains an efficient pattern in a way that bypasses the practical judgments of individuals about the pattern, we must assess the rules that define the corporate form as elements in a potentially authoritarian mechanism of social coordination.

7.6.8. The Rules of an Advanced Market Economy (Including the Rules That Define the Corporate Form) Must Together Satisfy the Three Requirements

An advanced market economy can avoid the charge of authoritarianism when its rules are structured in such a way that they satisfy the three requirements outlined earlier: reason sensitivity, transparency, and trustworthiness. When properly structured, the rules of market competition and corporate authority serve to draw citizens into a comprehensively reasonable pattern of production activity and consumption activity, where it would not have been possible for citizens to get together, synthesize the relevant information, discuss the issues, and draw themselves into the pattern on their own. But in order for an arrangement of this kind to be justified, it must be sensitive to the full range of relevant values; it must be (to the extent possible) transparent; and it must give citizens a reasonable basis for trusting in the process.

Editorial Preface to Chapter 8

By the time of Waheed Hussain's death, chapters 1–7 were largely finished. Chapter 8, however, was incomplete and not woven into the rest of the manuscript. We therefore decided to use materials from Hussain's two unpublished essays to complete the chapter: "Caveat Investor: An Alternative to the Fiduciary Theory of the Corporation" (2018; hereafter "Investor") and "The Social Governance Conception of the Market" (2016; hereafter "Governance"). We now briefly explain how these two texts help complete Hussain's argument.

Chapter 7 concluded by explaining how an advanced market economy can avoid the charge of authoritarianism: "it must be sensitive to the full range of relevant values; it must be (to the extent possible) transparent; and it must give citizens a reasonable basis for trusting in the process." Together, these ideas comprise "an intermediated market arrangement" in which people's market choices, as well as the choice sets themselves, meet the Kantian standard of rational justification to each person.

A negative extension of these ideas starts from Hussain's conception of an advanced market economy as a dynamical interaction system (section 8.1). This conception contradicts the influential fiduciary theory of the corporation, according to which "shareholders . . . entrust the management of their assets to its corporate officers" ("Governance," 2), since the fiduciary theory fails to meet the mooted standards of rational justification. Indeed, the fiduciary theory is part of the problem: by insisting that a corporate officer's sole purpose ought to be maximum shareholder value, the theory fetishizes one of her many functions. As chapter 7 has already explained, the Exxon Mobil CEO is not a person but an institutional structure. That structure, Hussain now argues, allows for the pursuit of ends other than maximum shareholder value, the ends that justify market institutions in the first place (section 8.2).

The positive implication of Hussain's critique of the fiduciary theory is that of an institutional arrangement where the choices of market participants, as well as the production of their choice sets, meet standards of rational justification (section 8.3). This arrangement Hussain dubs "intermediated" and draws upon Northern European–style codetermination to illustrate it (section 8.4). The ideal arrangement meets standards of rational justification, evidenced in the more egalitarian structures of remuneration and predistribution it would foster (section 8.5). And although Hussain's positive proposal faces numerous obstacles of implementation, information, and agency, they are not, he argues, insurmountable (section 8.6).

This reconstruction is, we believe, faithful to the tenor of the rest of Hussain's book, his unpublished essays, as well as numerous conversations he held with us and others on the central claims of chapter 8.

8
An Intermediated Market Arrangement

In the previous four chapters, I developed a view about the relationship between markets and freedom. An advanced market economy is a social coordination mechanism: a way of getting ourselves organized to produce and consume things in a certain way. The mechanism is distinctive because it maintains a certain kind of society-wide pattern of production activity and consumption activity (i.e., a Pareto efficient pattern), and it does so through a process that bypasses the practical judgments of individual citizens about the merits of the pattern. The market raises special questions about freedom insofar as it draws people into particular patterns of activity, but does so in a way that does not properly *address* market actors as agents who have their own point of view.[1]

8.1. Corporations and Other Business Enterprises as Players in Dynamical Interaction Systems

An advanced market economy is a dynamical interaction system.[2] As I noted above, systems of this kind can define the players that take part in the interaction in certain ways in order to advance the justifying aims of the enterprise. In the case of a course-scheduling scheme at a university, for example, the system can divide the faculty and students into different departments, where each department has its own faculty members and its own internal governance procedures. The system may assign certain powers and responsibilities

[1] [In the next two sections, Hussain argues that corporations need not be exclusively devoted to maximizing profits. Freed of this constraint, they could cease to be a judgment-bypassing source of unfreedom for market participants and instead become a source of freedom, by enabling workers to control the patterns of market activity into which they are drawn. Section 8.3 introduces a model of how this can be done, which Hussain calls "intermediated capitalism" and which works as an *alternative* to the pure legislative models discussed in chapter 7.—Eds.]
[2] ["Governance," 18 starts.—Eds.]

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to departments, such as the power to approve classes and to compete with other departments for resources. By creating these artificial agents and assigning them various powers and responsibilities, the governing structure of the university can advance the overarching goal of a process that consistently generates a program of study that answers to the changing judgments of professors and the changing interests of students.

The example of departments in a university is one instance of a more general phenomenon (see Hussain and Sandberg 2017). Many dynamical interaction systems define artificial players that can take part in the interaction when this can advance the underlying goals of the arrangement. In sports leagues, such as the NBA and NFL, there are various rules that define and order the internal division of the league into teams, setting out the powers that these organizations have to draft players, trade them, and pursue winning strategies. A league will often modify the rules governing team structure in order to achieve goals, such as parity and competitiveness, which are important to the underlying aim of the institution. Similarly, democratic electoral systems, such as those in the United States and Canada, have an array of rules that define and structure political parties. These rules govern the formation of parties, the dissolution of parties, and the ordinary powers that parties have to field candidates and shape an electoral platform. The community modifies these rules from time to time, making it easier or harder to form parties, so as to ensure that parties fulfill their function in a broader democratic system designed to ensure citizen control over public life (see Beitz 1989).

The literature on corporate governance, whether in legal theory or in economics, is best understood as addressing questions about the best scheme of rules for structuring the formation, normal operation, and dissolution of business enterprises. One important question has to do with the basic rationale for these enterprises. Why have firms at all rather than an arrangement with nothing but open market transactions? Ronald Coase (1988a) famously argues that the point of the firm is to perform certain coordination operations that would generate Pareto improvements in society but would not occur in the open market because of transaction costs.[3] Coase's theory gives us an account of why an advanced market economy should have business enterprises in the first place, while also giving us some direction in addressing questions about the formation and dissolution of these

[3] [See section 7.2.—Eds.]

enterprises—e.g., the rules governing the formation of business enterprises and bankruptcy should be designed to ensure that firms have an appropriate size, given the types of impediments that stand in the way of coordination through open market transactions.

Another issue that bears on business corporations is competitive selection. Besides making up for deficiencies in open market contracting, business enterprises also have an important role in the market because these organizations can experiment with different technologies and modes of production (see Hayek [1945] 1996, 1960; Schumpeter 1942). There is a process of natural selection in the marketplace, such that more efficient businesses push less efficient ones into bankruptcy, and over time this process helps to ensure that society, as a whole, is using the best means possible for satisfying the needs of individuals. One of the organizing aims of bankruptcy law is to ensure that the competitive process works effectively, allowing for even radical innovation, disruption, and "creative destruction."

I should also note in passing an important question about the normal operation of business enterprises. What should these organizations be aiming to do? The most widely accepted answer to this question is that corporations should be aiming to make a profit and generate returns for shareholders (see Jensen 2001, 2002; cf. Hussain 2012c). The basic argument for this view situates business corporations within the framework of an advanced market economy. The idea is that when the price system is working the way that it should, corporations contribute to social welfare when they focus their attention on making profits and thereby producing goods that generate a net increase in consumer satisfaction.[4]

Most of the literature on corporate governance, whether in legal theory or in economics, dovetails with my functionalist conception of business enterprises.[5] This follows naturally from the fact that this literature is strongly influenced by economics, and economics essentially takes it for granted that an advanced market economy is a dynamical system and that business enterprises have a particular role to play in this system. But the functionalist view of business enterprises that I have presented here contrasts with many philosophical accounts of the business corporation. For instance, Christian

[4] [Contrast: "[A]n authority structure is not morally justified simply in virtue of the fact that it brings about a more efficient pattern of production and consumption in society. . . . It would be disrespectful to allow officeholders simply to draw citizens into the right patterns, without offering citizens any basis for understanding why these patterns in their work lives are justified" (147f).—Eds.]

[5] [See section 7.2.—Eds.]

List and Philip Pettit (2011) conceive of the business corporation as a collective agent in the more general sense of a moral agent that can be held morally responsible for actions that may harm others. This view differs from the view that I have laid out here because it does not specifically situate the business corporation in an economic arrangement that has certain distinctive justifying aims.[6, 7]

8.2. *Caveat Investor:* An Alternative to the Fiduciary Theory of the Corporation

Here is a common way of thinking about the corporation.[8] Shareholders own the assets of a business enterprise, but they do not have the time or expertise to manage them, so they hire full-time managers to do it for them. In hiring managers, shareholders empower these individuals to control the corporation's assets for the purposes of maximizing their returns. By accepting managerial positions, managers take on a positive obligation to make decisions that will promote the basic objective of shareholders. So as managers make decisions about what products to make, how to make them, how to market them, etc., they have both the authority and an obligation to make as much money for their shareholders as they can, within the constraints of the law and morality. If at some point they make a decision that aims to promote some other goal besides making money for shareholders—say, saving the rainforest—they both overstep the bounds of their legitimate authority over the corporation's assets and violate their fundamental duty to shareholders. They are essentially "hijacking" the corporation for their own personal use.[9]

Let's call the common way of thinking I just described the *fiduciary conception* of the corporation. The conception is "fiduciary" in the sense that it is based on the idea that when shareholders invest in a corporation, they *entrust* the management of their assets to its corporate officers. As a moral

6 ["Governance," 20 ends.—Eds.]

7 [Hussain and Sandberg (2017, 5) elaborate this as follows: "[W]hen it comes to the important social, moral and political questions that surround business corporations in contemporary liberal democracies, this metaphysical or pre-institutional sense of collective agency is largely irrelevant. To answer the important questions, we must think of collective agency as a feature of our social practices, one that serves or may serve the goals, aims and values that justify these practices."—Eds.]

8 ["Investor," 1 starts—Eds.]

9 I take the common view of the corporation that I am describing to be the view that Milton Friedman (1970) advocates in his famous essay on the social responsibility of the corporation.

theory of the corporation, the fiduciary conception is supposed to offer us a set of ideas that will help us to think through questions about the obligations of managers, while at the same time providing us with an illuminating justification for these conclusions. I will argue, however, that the fiduciary conception fails to do this. In particular, it fails to come to terms with an important aspect of the corporation, namely its *independent* character. The fiduciary conception paints a highly personal picture of the connection between managers and shareholders, and this seems to conflict with many commonsense intuitions about the nature of a corporation.

My plan for this section is as follows. I will begin by articulating the fiduciary conception in a way that brings out its moral underpinnings, and then I will criticize the view for failing adequately to account for the independent nature of the corporation. Once I have set out the fiduciary view and criticized it, I will begin to develop an alternative conception, one that appeals to a different set of ideas to make sense of the corporation and the obligations of managers within it. My view will accommodate the independent character of the corporation better than the fiduciary conception does, and I believe that it will show that the obligation of managers to pursue the interests of shareholders is not nearly as strict as it is sometimes taken to be. My overarching goal is to deflate the character of the managerial obligation to pursue the interests of shareholders, making room for a more complex view of what the obligations of managers might be.[10]

8.2.1. The Fiduciary Theory of the Corporation

I want to begin by articulating the moral idea that underlies the fiduciary conception of the corporation. The best way to do this is by means of an example.

Imagine that your parents are coming to visit you this weekend and you want to pick them up at the airport. Unfortunately, you have a scheduling conflict and you can't pick them up yourself, so you ask your friend to do it for you. Suppose that he accepts. We might say, at this point, that you *entrust* your friend with the task of picking up your parents with your car. By entrusting him with this task, you have done two things. First, you have given

[10] ["[I]n order for an arrangement of this kind to be justified, it must be sensitive to the full range of relevant values, it must be (to the extent possible) transparent, and it must give citizens a reasonable basis for trusting in the process" (164).—Eds.]

him a certain limited authority to make decisions about your car. When you give him the keys, your friend gains *de facto* control over your car, but since you have not transferred *ownership* to him, whatever authority he has over the car derives ultimately from your authority over it. Insofar as you give him the car for the purpose of picking up your parents, it is natural to think that his authority over the car extends only as far as is necessary for him to carry out this task. Second, by accepting, your friend now has a positive obligation to use his *de facto* control over your car actively to pursue your ends. So if the weekend comes around and your friend makes no effort to get your parents, there is no obvious sense in which he has overstepped the bounds of his legitimate authority over the car—he has not used it in ways that are impermissible. Nonetheless, by failing to make any effort to get your parents, he *has* violated his positive obligation to pick them up, an obligation that stems from the fact that he agreed to do this for you. To illustrate the significance of the underlying idea, suppose that your friend is on his way to the airport to pick your parents up and the car starts running low on gas. Though you did not specifically tell him that he could stop off at a gas station to fill up, there would be nothing wrong with him pulling over and doing so. Stopping for gas is essential if he is going to pick your parents up, so it both falls within the purview of his delegated authority over your car and is consistent with his positive obligation to further your ends. But now suppose that your friend decides to drive down to Daytona Beach for Spring Break. Driving to Daytona Beach has nothing to do with picking your parents up, so your friend is overstepping the bounds of his legitimate authority over your car—he is "hijacking" it for his own purposes. Moreover, since going to Daytona Beach will interfere with his getting to the airport on time, he is also violating his positive obligation to pick your parents up.

The fiduciary conception uses the idea of "entrusting people" as the basis for a moral theory of the corporation. It starts with the idea that we each have a certain moral power to entrust people with our property for the purposes of pursuing our ends—the case of entrusting your friend to pick your parents up at the airport is one example. The fiduciary conception suggests that shareholders exercise this same power when they empower managers to make money for them using their assets. Shareholders are in a position analogous to you in the example and managers are in a position analogous to your friend. Shareholders own the underlying assets of the corporation in much the same way that you own your car. They entrust managers to pursue a certain end using these assets, namely increasing returns. When managers accept, they gain *de facto* control over the assets of the corporation, but their authority is limited because they do not *own* these assets. Their authority derives ultimately from the authority of shareholders, and it seems reasonable to think that the authority granted by shareholders extends only as far as is necessary to pursue the goal of increasing returns. By the same token, managers have a positive obligation to use their *de facto* control over the assets of the corporation in ways that promote the interests of shareholders because they agree to do so when they accept their positions. So imagine that a manager decides to use a more expensive production process because it uses less material from Brazil and this will help to save the rainforest. By using the assets of the corporation to pursue some other goal besides increasing returns, the manager is essentially "driving to Daytona Beach." On the one hand, he is using the assets of the corporation to pursue objectives other than increasing returns for shareholders, which amounts to hijacking these assets for his own purposes. And on the other hand, he is sacrificing shareholder returns, which amounts to a violation of his positive obligation to promote this end.

It is important to be clear about the nature of the fiduciary conception and the difference between this view and other competing views. For one thing, we should not confuse the fiduciary conception with a generally utilitarian approach to the corporation. According to a familiar utilitarian argument, managers should maximize returns for shareholders because this would lead to a higher level of aggregate welfare in society. An economy consisting of corporations that maximize returns for shareholders tends to be more efficient than one in which corporations pursue other objectives, so one might argue that the aggregate level of welfare in society would be higher if managers were required to pursue these ends.[11] From the utilitarian standpoint, the fact that aggregate welfare would be higher if managers maximize returns for shareholders means that managers have a duty to pursue this objective. I take it that the utilitarian argument for maximizing returns for shareholders is different from the fiduciary conception. On the fiduciary view, the reason that managers are obligated to maximize returns for shareholders is because shareholders entrust them with this task. According to the utilitarian argument, by contrast, the reason that managers should

[11] There is a large literature that addresses the relative efficiency of an economy in which firms seek to maximize returns for shareholders. See, e.g., Jensen (2000); Hansmann (1996). It is essential to distinguish this utilitarian argument from other arguments for profit maximization, such as the fiduciary argument. For a discussion of these issues, see Hussain (2012a).

pursue this goal has little to do with shareholders but stems rather from the fact that society as a whole would be better off if managers acted this way. The fiduciary view is, at bottom, a deontological conception of the corporation, not a consequentialist one.

We should also distinguish the fiduciary view from a conception of the corporation based simply on the idea of a contract. According to the fiduciary view, managers have an obligation to pursue the interests of shareholders, even if there is no contract that explicitly sets out that they have an obligation to do so. In cases where managers are employed "at will," without an explicit legal contract, the fiduciary view would say that they still owe it to their shareholders to maximize the returns on their investment. This marks one important difference from the contract view. Another important difference is that the fiduciary view aims to tell us something about the shape and structure of the law. The law places certain demands on corporate managers that have nothing in particular to do with the contractual arrangements between the various parties. For example, managers have to make the financial records of the corporation available for investors to examine, and this requirement holds even if it is not explicitly mentioned in any contract between investors, managers, and the corporation. The idea of respect for contracts on its own tells us little about how we should structure the various laws that regulate the corporation independently of the contractual arrangements between the parties. By contrast, the fiduciary view does tell us something about how these laws should be structured: it says that the laws of business should be structured around the idea that shareholders own the business enterprise and that managers have an obligation to further the interests of shareholders within the bounds of other aspects of the law and basic morality.

With a basic understanding of the fiduciary conception of the corporation, I want to turn now to several criticisms of the view. The problems that I want to focus on have to do with the character of the relationship that the fiduciary view suggests exists between shareholders and the corporation.

8.2.1.1. Limited Liability

Perhaps the most important feature of the modern business corporation from the moral point of view is limited liability. If I take a loan out from a bank and I cannot pay it back, the bank can make a claim on all of my personal assets as payment for the loan. By contrast, when I invest in a corporation, my risks are limited to the amount that I actually invest in it. So when a corporation takes out a loan from a bank or issues bonds, shareholders are not personally liable if the corporation fails to repay these debts. Creditors can make claims on the corporation's assets, but they cannot make claims on the personal assets of shareholders.[12] No legal relationship exists between the corporation's creditors and its shareholders, and the most that shareholders can lose is the amount of money that they originally invested in the enterprise.

Unfortunately, the fiduciary conception of the corporation seems to be at odds with the idea of limited liability. The central idea behind limited liability is the idea that the corporation is an independent entity, one that can enter into contracts and incur debts that have nothing to do with the individuals who occupy its various offices or those who invest in it. The fiduciary view suggests that there is no intermediary that stands between shareholders and the assets of the corporation. Shareholders own the corporation's assets and merely entrust managers with them as a way of furthering their goal of making money. It is the fact that these assets belong *to them*, not some other entity, that forms the basis of their claim that managers should be pursuing *their* interests when making business decisions. But if the assets of the corporation belong to them personally, then there is no *prima facie* reason to think that there is a separation between the assets of the corporation on the one hand and the personal assets of investors on the other. So it is hard to make sense of the idea of limited liability on the fiduciary view.

An example may help in seeing the force of the point. Suppose that you buy an ice cream parlor and pay the suppliers, employees, and others from your own personal funds. One day you find that you lack the time and expertise to run the place, so you hire a manager to run it for you. When you entrust him with the business, you give him the authority necessary to run its day-to-day operations and he incurs a positive obligation to exercise your property rights in ways that will further your interests. Your personal ownership over the parlor, the machinery, the bank accounts, and everything else is essential on the fiduciary view because this is what forms the basis of the claim that the manager of the enterprise should be pursuing your interests. But now if you own all of the assets of the enterprise in this way, then it seems that there is no intermediate entity that stands between you and the corporation's operations. Even if your manager makes all the right choices, it may turn out that business slows down and revenues are not sufficient to cover costs. If the manager was simply acting as your agent, exercising delegated control over your building, your machinery, and your bank accounts, then it seems that

[12] Except in special cases involving fraud, deception, or failures of incorporation.

there is nothing that stands between your personal assets and the creditors that are looking to get paid. When the store manager pays the ice cream supplier and the electric company, he does not do so with *his* money or with the *company's* money; he does it with *your* money, acting on your behalf. So it seems natural that when the bills have to get paid, creditors will look to you to cover the costs incurred by your manager's actions.

It seems, then, that there is a conflict between the fiduciary conception of the corporation and the idea of limited liability. If shareholders own the assets of the corporation in a way that could provide a basis for the claim that managers must pursue their interests, then it seems that there is no intermediate entity that owns these assets and that creditors should be able to look to shareholders for payment when revenues do not cover costs. In fact, the claims of limited liability seem transparently self-serving on the fiduciary view: it is awfully convenient for shareholders to claim that the corporation belongs to them personally when it comes time to decide how profits should be distributed, but then to repudiate the corporation when it comes time to pay suppliers, customers, and employee pension plans.

8.2.1.2. Resolving the Conflict of Duties

A second problem with the fiduciary view is that, taken on its own, it actually tells us very little about what the managers of most publicly held corporations should do. To see why, let's imagine that shareholders own the corporation in the way that the fiduciary view suggests. It follows that managers have an obligation to pursue the interests of shareholders. When there is only one shareholder or there is complete agreement among shareholders, the fiduciary view seems to give managers relatively clear guidance about what to do. But publicly held corporations have hundreds, sometimes thousands of shareholders, each with her own distinctive set of goals. In these cases, the fiduciary theory gives the manager very little guidance about what to do. After all, the view says that managers have an obligation to pursue the ends of each shareholder, so when there is a conflict among the ends of shareholders, there is simply no fact of the matter about what a manager should do. We have a pure conflict of duties.

Here's an example to illustrate. In the late 1980s there was a serious dispute among shareholders at AT&T about their affirmative action program.[13] Shareholders agreed that they wanted the corporation to make money for

[13] See Beauchamp (2004).

them, but they disagreed vehemently about how it should go about doing so. Some believed that AT&T should accelerate the process of overcoming a history of discriminatory hiring practices at the corporation by using preferential hiring policies to bring more women and minorities into the workforce. Others argued that AT&T should not engage in any form of preferential hiring, not simply because it would hurt the bottom line if the best qualified candidates were not hired but because it would be immoral to make hiring and promotion decisions on the basis of gender and race. Given this disagreement about how the corporation should go about making a profit, the fiduciary conception says that it is simply indeterminate what managers at AT&T should do. On the one hand, they have an obligation to pursue the ends set for them by those who want to introduce a preferential hiring policy, and on the other, they have an obligation to pursue the ends set for them by those who oppose the preferential hiring policy. What we have here is a pure conflict of duties. In fact, it seems that *anytime* there is a disagreement among shareholders, the fiduciary conception leaves managers without any clear guidance about what they should do.

Defenders of the fiduciary view might argue here that all their view needs is a collective decision-making rule to determine what managers should do in cases where there is a conflict among shareholders. For example, maybe the fiduciary view should say that in cases of conflict, mangers have an obligation to do what the majority of shareholders in the corporation want them to do.

Unfortunately, merely stipulating a decision-rule will not address the underlying moral issue. Consider that on the fiduciary view, managers have an obligation *to each shareholder*: each shareholder entrusts his assets to managers, so managers have an obligation to pursue the interests of each shareholder. In order for a collective decision-making rule to have any moral significance, for managers, each shareholder would have to be *bound* to abide by the collective decision rule. If I entrust my assets to X as a way of furthering some goal G, the mere fact that a lot of other people would like X to pursue some other goal H does not release X from his obligation to further G. By the same token, if a minority of shareholders opposes affirmative action, managers at AT&T still have an obligation to further their ends, even if it turns out that most other shareholders reject this position. There is still a mere conflict of duties. In order for the vote to have any moral significance, it must be the case that shareholders who voted against the plan have some kind of obligation to direct managers to pursue it anyway. Unless some such obligation exists, the collective decision-rule simply has no significance from the point of view of the manager's obligation. So without some definite moral argument in favor of a collective decision-rule, the fiduciary conception has *nothing* to say about what managers in most publicly held corporations should do.[14]

8.2.1.3. Overly Demanding

A third problem with the fiduciary view is that it seems overly demanding given a reasonable degree of liquidity in capital markets.[15] Suppose that management adopts a production process that lessens returns for shareholders but will help in the long run to save the rainforest. Suppose that a group of shareholders disagrees with this decision and would prefer that managers simply maximize the returns on their investment. What might these shareholders do? Perhaps the most natural thing for them to do is simply to take their money elsewhere. If they do not like the policies that management is pursuing, they are free to sell their shares and move their money to some other corporation. There is mobility in the capital market just as there is mobility in the labor market, and when workers don't like their jobs, we sometimes say that they are free to work somewhere else, so the natural thing to say if shareholders don't like what managers are doing is that they are free to take their money elsewhere.

The fact that there is liquidity in capital markets suggests that the fiduciary conception of the corporation is overly demanding. In the case where you entrust your friend to pick your parents up with your car, part of the reason why we feel that your friend is under an obligation is that once the car is in his hands, there is very little that you can do to protect your property. But the same is certainly not true in the case of the corporation. Though the assets of

[14] Proponents of the fiduciary view often hide this problem by implicitly assuming a certain decision rule. Friedman, e.g., suggests that managers should pursue the one goal that most shareholders would endorse, namely maximizing returns on their investment. But in order for managers to be bound to pursue this end, it is not enough for shareholders to generally want to pursue it; there must be some sense in which they are bound to direct managers to pursue it. So suppose that I am a committed environmentalist and that I would pursue profits only in ways that minimize costs on the environment. When managers maximize returns on my investment without regard for the environment, there is an obvious sense in which they are not pursuing my ends. And even if it is true that *other* investors do not share my concern for the environment, their opinions are irrelevant as far as my assets are concerned. With regard to my assets, there is an important sense in which managers have hijacked what belongs to me in order to pursue their own ends. What the proponent of the fiduciary view has to show is that I am somehow obligated to revise my ends and direct managers to pursue profit in ways that might sacrifice the environment. Unless the proponent of the fiduciary view can say something about why I must revise my ends in this way, it is hard to see why managers are not simply overstepping the bounds of their authority over my assets and violating their positive obligation to pursue my ends.

[15] John Boatright (1994) makes an argument along these lines.

the corporation themselves are not under the control of investors, the *particular investment* that each shareholder has in the corporation *is* under his control.

In most cases, a shareholder can protect himself against the effects of decisions that he does not endorse by simply selling his shares and taking his money elsewhere. Given that shareholders can protect themselves in these ways, it seems very heavy-handed to think that these managers have an obligation to shareholders that is anything like the obligation that your friend has to you when you entrust him with your car.[16]

8.2.2. A Fair and Efficient Division of Responsibilities in Capital Markets

At this point, I have described the fiduciary theory of the corporation and suggested some reasons why we should be skeptical about it. I want to turn now to an alternative view that I think is more attractive and fits better with the independent nature of the modern corporation. There are two parts to the view. One is an account of the nature of the corporation and the basic rationale for its existence, while the other is an account of what managers owe to shareholders. I will concentrate mostly on the second part of the view, but I want to start by saying something about the first part.

8.2.2.1. The Nature of the Corporation and Its Rationale

Corporations come in many shapes and sizes. Though we are mainly interested in private, for-profit enterprises, it is important to think about these corporations in the context of the wider range of enterprises that constitute corporations in the ordinary sense. Corporations fall into two broad categories: public and private. Public corporations are established by the government, and their main purpose is to provide some service to the public. Public corporations are often nonprofit enterprises, but they need not be. The

[16] In "The Social Responsibility of Business Is to Increase Its Profits," Friedman (1970) draws a parallel between corporate spending on social causes and taxation. He suggests that when an executive spends profits on social causes, he is essentially imposing a tax on shareholders and deciding how this tax will be spent. However, the two cases seem hardly parallel. Taxes imposed by the government are coercive because there is no real way for individuals to avoid paying them—you could emigrate from the country, perhaps, but for most people that is simply not an option. By contrast, managerial expenditures are not coercively imposed on shareholders because if they don't like the way that managers are running a business enterprise, they are free to sell their stake and invest in another corporation.

Tennessee Valley Authority, e.g., is a public corporation that was established by the government to manage public lands in and around the Tennessee River in the interests of national defense, industrial development, and public safety. But Amtrak is a public corporation established by the government to provide passenger rail service to the public in the interests of making a profit. Private corporations, on the other hand, are established by private citizens, and their purposes vary widely. Many private corporations are not-for-profit enterprises, such as hospitals, universities, and churches, which are simply established to provide some service to the public or to pursue some other goal. But many private corporations are for-profit enterprises—e.g., Coca-Cola, Boeing—and they are established to provide goods and services to the public for the purposes of making money. There are several important similarities between different sorts of corporations, whether they are public or private, for profit or not for profit.

First, all corporations are characterized by limited liability. Each of these enterprises operates as an independent entity that is distinct from the various individuals who occupy offices within the organization and from the individuals who invest in it. Creditors can make claims on the assets of the corporation itself only because their agreements are ultimately with the corporation, not with the individuals who manage it or invest in it.

Second, all of these corporations have articles of incorporation that state what the fundamental purpose of the corporation is supposed to be. Amtrak's articles of incorporation, e.g., state that the purpose of the corporation is "to revitalize rail transportation service in the expectation that the rendering of such service along certain corridors can be made a profitable commercial undertaking."[17] Coca-Cola's articles of incorporation say that its purpose is "to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware."[18]

Third, all of these corporations have articles of incorporation that resemble the constitution of a nation-state in that they establish a set of procedures for setting policies and making decisions. Amtrak, e.g., has a nine-member board of directors that includes the US secretary of transportation, the president of Amtrak, five members appointed by the president of the United States (subject to congressional approval), and two members appointed by those

[17] 1970 US Code Congress & Administrative News 4735, 4737, 4741.
[18] https://www.sec.gov/Archives/edgar/data/317540/000156459017016586/coke-ex31_322.htm.

who hold preferred stock in the enterprise. Coca-Cola similarly has a board of directors whose members are elected by shareholders.

The power to create a corporation is one of the most important powers available to us under our economic system. We should think of this power as one among a variety of instruments, such as property rights and contracts, which allow us to pursue our ends in association with others. In order to understand the purpose of a corporation, it is important not to focus simply on existing corporations and ask what their members are trying to do; we must focus on the power to form a corporation and ask what role this power plays in our system. Why should our economic practices include the power to incorporate a business enterprise? Why should we want a system of corporate capitalism that allows us to form corporations, rather than a system of personal capitalism in which business is conducted simply through property rights and personal contracts?

I take it that an important part of the rationale for corporate capitalism is that introducing corporations into the mix of basic instruments helps to encourage social innovation.[19] Giving people the power to incorporate a business enterprise makes it easier for them to exploit economies of scale and scope.[20] Under personal capitalism, there may be some people who are rich enough to set up large-scale factories that can produce goods in quantities that are sufficient to take advantage of savings that come from consuming raw materials in bulk. And there may be some who are rich enough to set up large-scale business operations that can produce a range of different products that all employ certain common components. But under corporate capitalism, you not only have these rich people, but you also have a lot of other, less rich people who can pool their resources to exploit these possibilities. Of course, pooling resources is possible under personal capitalism; it's just that corporate capitalism facilitates the process of amassing capital to exploit economies of scale and scope.

Adding corporations to the mix of basic instruments also helps to encourage the pursuit of socially useful ideas by lowering risks for investors. If the power to incorporate a business enterprise were not available to people, then whenever someone had a good idea for a business, she would have to

[19] [See chapter 3.—Eds.]

[20] Alfred Chandler (1977) famously argues that the rise of the modern business corporation was tied to the rise of the telegraph and the railroad. These technologies made it possible for people to exploit economies of scale and scope for profit, though it would require a much larger, more complicated, and more demanding form of business organization to do so.

risk her own financial future in order to pursue it. But the power to incorporate a business enterprise allows individuals to manage their exposure to business risk by contributing only a certain part of their personal wealth to the business venture. So, e.g., suppose that I have a great idea for a new way to distribute music on the internet. The power to incorporate a business enterprise allows me to pursue this idea without risking my house, personal savings, and credit history. I can set up a corporation and contribute only some part of my personal wealth to the pursuit of this idea. By the same token, the corporation allows other potential investors to limit their exposure in much the same way, by contributing some limited portion of their wealth to the project. In this way, the power to incorporate helps to encourage social innovation by allowing people to establish an independent legal entity and use it to manage their exposure to financial risks.

When theorists talk about the purpose of the corporation, they often come to the conclusion that the purpose of the corporation is to make money for shareholders. When separated from the fiduciary conception of the corporation, it is hard to see what the rationale for this claim could be. People establish corporations for all sorts of reasons: sometimes they are interested in a money-making venture, sometimes they are interested in providing a public service, and sometimes they are interested in some combination of the two. There is no more reason to think that every corporation is established to further the same end than there is to think that every contract is entered into to further the same goal. Of course, when you move from particular corporations to the power to form a corporation in general, it seems that there is something that unites most corporations. We have reason to prefer an arrangement that allows us to form corporations over one that does not because these instruments allow us to pursue our ends while controlling our exposure to risks. But the fact that the power to form a corporation is valuable in this way should not lead us to think that corporations have some underlying goal that they all pursue.

The point of these observations is that if you want to know what the purpose of some corporation is, you cannot simply contemplate "the nature of the corporation." Corporations have no intrinsic goals, any more than contracts do. To see what the goal of a corporation is, you have to look at that particular corporation and examine its stated objectives. Since the corporation's articles of incorporation serve as its constitution, it seems natural to look to these articles for a statement of the guiding idea behind the organization. Once we distance ourselves from the idea that corporations must, by their very nature, generate profits for shareholders, we can think more clearly about what the basis might be for thinking that corporations should sometimes pursue this goal. What sorts of obligations do these enterprises and their managers owe to those who invest in them? This is the question that I will address in the next section.

8.2.3. Capital Markets and Legitimate Expectations

Corporations are independent legal entities, distinct from both the individuals who occupy offices in the corporate hierarchy and the individuals who happen to own shares at any given time. Each corporation has articles of incorporation that set out its basic goals and set out the procedures through which the organization will be governed. As investors enter the capital market, they face an array of different corporations in which they can invest. They are free to investigate their alternatives and make a decision about where to put their money. Assuming a certain degree of liquidity in the capital market, investors can expect to be able to buy and sell shares both in response to changes in economic circumstances and in response to managerial decisions. Given these basic facts, how should we think about the duties that managers owe to shareholders?

I think that we can look to another market to provide us with a good model. Let's compare the situation of investors in the capital market with the situation of consumers in the market for goods and services. When consumers come to the marketplace, they have all sorts of expectations about manufacturers and the goods that manufacturers produce. Some of these expectations are *legitimate* in the sense that consumers have a right to rely on these expectations in making decisions, and manufacturers have a corresponding duty to live up to these expectations. By contrast, other expectations are not legitimate in the sense that consumers have no right to rely on these expectations in making decisions, and manufacturers have no corresponding duty to live up to them. For example, one expectation that consumers may have of the marketplace is that managers will not make false statements about their products. This expectation is legitimate because consumers have a right to rely on it in making decisions about what to buy, and manufacturers have a corresponding duty to live up to it. Another expectation that consumers might have is that the products they buy are durable and made to last. This expectation is not legitimate because consumers have no moral right to rely on it and because manufacturers have no moral duty to live up to it.

In order to distinguish legitimate from illegitimate expectations, we have to think of the rights and duties of market actors as defining a kind of division of labor. Whenever consumers have the right to rely on a certain expectation, this represents a benefit for consumers and a burden for manufacturers. For example, when consumers have the right to rely on the expectation that manufacturers are telling the truth about their products, this represents a benefit for consumers (they do not have to spend their time verifying what manufacturers say) and a burden for manufacturers (they have to spend time making sure that what they say is true and accurate). Conversely, when consumers have no right to rely on the expectation that manufacturers are producing durable, long-lasting products, this represents a benefit for manufacturers (they are free to produce cheap junk) and a burden for consumers (they have to make more of an effort to find durable and long-lasting goods).

Morality requires that the division of responsibilities in the marketplace should be both fair and efficient. We can think of fairness in the following way. Each group in the marketplace has certain basic interests, such as the consumer's interest in being able to find the goods that he wants. The division of responsibilities in the marketplace will serve some interests and conflict with others. The division of responsibilities is fair when each group finds that their interests are accommodated in a reasonable way given the interests of the other groups. The division of responsibilities is efficient when no group's interests are sacrificed for reasons that have nothing to do with the interests of another group. Expectations in the marketplace are legitimate when they correspond to a fair and efficient division of labor, and expectations are illegitimate when they correspond to an unfair and inefficient division of labor.[21]

I want to concentrate mostly on the idea of fairness, so let's consider an illustration from the law. Consumers may expect that the products they find in the marketplace are safe for their normal uses—e.g., when you go to RadioShack, you expect that whatever radio you buy, it will not electrocute you when you turn it on. For many years, the law in the United States did not recognize this as a legitimate expectation. Under the *caveat emptor* regime, it was the buyer's responsibility to examine the products that he finds in the marketplace to determine whether they are safe. Manufacturers had

[21] [See section A.2.6.—Eds.]

no legal responsibility to ensure that the products they brought to the market were safe for their intended uses. The *caveat emptor* regime may well have represented a fair and efficient division of labor in a simpler time, when the market consisted mostly of goods such as apples and shovels that most people could assess for themselves. But in a more complex marketplace, with technologically sophisticated products that consumers often buy without an opportunity for inspection, the *caveat emptor* regime does not represent a fair and efficient division of responsibilities. Consumers have an interest in not being exposed to certain sorts of risks, but the *caveat emptor* doctrine allows manufacturers to impose all sorts of risks on them—after all, most consumers are not in a position to determine whether the brakes on their new car will actually stop the vehicle in an emergency. This seems unfair given that we can protect consumers from these risks at a reasonable cost to manufacturers. Fairness seems to tell in favor of a regime that places greater burdens on manufacturers to bring safe products to the marketplace, thereby protecting consumers from exposure to certain sorts of risks.

Questions about the duties of managers and investors in the capital market can and should be understood on the model of questions about the duties of manufacturers and consumers in the market for goods and services. Investors come to the capital market to buy shares in corporations. They have various expectations about how corporations will act. Some of these expectations are legitimate in the sense that investors have a right to rely on these expectations in making investment decisions, and corporations have a corresponding duty to live up to these expectations. But some of these expectations are not legitimate in the sense that investors have no right to rely on these expectations in making investment decisions, and corporations have no corresponding duty to live up to them. In order to determine which expectations are legitimate and which are not, we have to focus on the corresponding division of labor. Expectations are legitimate when they correspond to a fair and efficient division of labor in the capital market, while expectations are not legitimate when they correspond to an unfair or inefficient division of labor.

8.2.4. Which Expectations Are Legitimate?

I cannot offer a complete account of which expectations in the capital market are legitimate and which are not, but I want to examine a few expectations in order to suggest the broad outlines of what managers owe to shareholders under the kind of view that I am advocating.

(a) One expectation that investors should be able to rely on is that corporate financial statements will accurately depict the financial position of the corporation. Investors have an interest in being able to make informed decisions about what sorts of risks they want to take, and they also have an interest in minimizing the time they spend investigating their alternatives. Suppose now that investors were not able to rely on the statements that corporations make. If they could not rely on corporations to provide them with accurate information, they would have to spend a substantial amount of time verifying the claims that corporations make. Moreover, they are rarely in a position to investigate the financial situation of a corporation for themselves, and they rarely have the expertise to formulate a general picture of the corporation's position given the raw data. The division of responsibilities in this case seems unfair because it places unreasonable burdens on investors given that corporations could make information available to investors at relatively little cost to themselves and because they have access to the expertise necessary to paint an accurate picture of their financial position. So it seems that fairness tells in favor of a division of labor in which corporations have a duty to provide accurate information about their financial position to investors and investors have a right to rely on these statements in making financial decisions.

(b) Another important expectation is that managers will come forward in cases where they have a conflict of interest. Again, investors have an interest in being able to make informed decisions about what sorts of risks they want to take, and they also have an interest in minimizing the time they spend investigating their alternatives. Suppose now that there were no duty for managers to come forward and inform investors when there is a conflict between their successfully carrying out their duties in the corporation and some other financial interest. Under this division of responsibilities, the burden would fall on shareholders to find out for themselves whether corporate managers have divided loyalties. This arrangement seems unfair because investors are rarely in a position to find out about the conflicting business interests of a manager. It would take an enormous amount of time for investors to monitor each of their various holdings to see whether the officers in each corporation had divided loyalties. A managerial obligation to disclose conflicts of interest would help to ensure that investors are in a position to make an informed decision about what sorts of risks they want to take on. Moreover, managers have ready access to the relevant information, so they would be able to provide this information to investors at relatively little cost to themselves. So it seems that fairness would tell in favor of a general obligation for managers to come forward in cases where they have a serious conflict of interest.

(c) Consider now an expectation that lies at the heart of the debate about corporate social responsibility. Imagine a division of labor in which corporations have no obligation to maximize returns for shareholders, but have an obligation instead to make their management policies known to investors. Under this regime, a corporation would be permitted to adopt, say, a policy of paying employees a living wage, even if this policy would lower returns for shareholders, so long as the corporation made clear to investors through a prospectus or some other means that this was the company's policy. Would this represent an unfair division of responsibilities?

Here it seems to me that the answer is no. The central interests involved are the shareholder's interests in being able to make informed decisions about the risks he wants to take, his interest in being able to further his ends through his investments, and his interest in minimizing the time that he has to spend investigating the alternatives. Under the arrangement that I described, shareholders would have reliable information made available to them about what sorts of policies a corporation was going to pursue. Given a certain degree of liquidity in the capital market, they would not only have an opportunity to make an informed decision, but they would also have ample opportunity to sell their investment and move their money to some other corporation if they did not endorse the new policies.

Some shareholders might complain that it is unfair of managers to adopt the living wage policy because this would lower the value of their investment. But the mere fact that it lowers the value of their investment is not enough to show that there is any unfairness here. Investors were fully aware of the risk that managers might adopt some such policy when they decided to invest in the corporation. And insofar as they assessed the risks and freely undertook the risk that managers might introduce such a policy, they can hardly complain of unfairness when they have to bear the cost of their initial decision.

Of course, the arrangement I described would place greater burdens on investors in terms of investigating their options, as there would be greater diversity among the corporations in the marketplace. Investors could not simply rely on the expectation that every corporation was aiming to maximize returns on their investment. But it is worth noting that this burden of investigation comes with an important benefit. Under the sort of arrangement that Milton Friedman favors, there is very little diversity in the market and all corporations simply maximize returns for shareholders. Under the arrangement that I am describing, investors have the option of investing in corporations that make money in ways that they would actually endorse. Instead of being limited to investing in corporations that make money in ways that might sacrifice other things that are important to them—say, the rainforest—investors now have the opportunity to invest in corporations that make money in ways that are consistent with their broader objectives. This is a significant benefit that seems to make the increased burdens of investigation reasonable from the shareholder's point of view.

(d) I want to conclude [this discussion] by noting that although the approach that I am advocating diverges from the fiduciary conception in many ways, there is one point on which I think that two views would agree. It seems to me that an approach based on the idea of a fair and efficient division of responsibilities in the capital market would strongly favor a *prima facie* requirement that corporations aim to generate increasing returns for shareholders. Although it is permissible for corporations to pursue other goals besides generating increasing returns, so long as it makes these policies clear to investors, it seems that in the absence of any such declaration, the default position should be a strategy of increasing returns. Shareholders should have a right to expect that, in the absence of declarations to the contrary, corporations are aiming to make money for them. The idea here is that most investors want their investments to yield high returns, much the same way that most consumers want products that are safe for their intended uses. Manufacturers have a *prima facie* obligation to bring products to the marketplace that are safe for their intended uses, and this allows consumers to concentrate their attention on

> finding products that further their ends in other ways. The equivalent claim in the capital market would be that corporations have a *prima facie* obligation to generate increasing returns for shareholders. This obligation would free investors from certain burdens of investigation, though allowing for corporations to pursue other sorts of ends when they make this clear and explicit.

I have argued that the fiduciary theory suffers from an important weakness: it does not come to terms with the independent character of the modern corporation. The fiduciary view seems to rely on the idea that investors have a direct ownership claim on the assets of a corporation, which then entitles them to determine what goals the corporation should pursue. This conflicts with the idea that investors enjoy the protection of limited liability because the corporation is an independent legal entity that stands between investors and the various activities of the business enterprise.

In contrast to the fiduciary theory, I have offered an alternative that acknowledges the full independence of the corporation. Corporations are free-standing enterprises that individuals and governments establish to pursue various ends. The reason that corporations have obligations toward investors has little to do with the fact that investors own the corporation in the way that the fiduciary view suggests. Rather corporations have duties to investors because corporations participate in capital markets, looking for investors. Morality requires that there should be a fair and efficient division of labor in the marketplace. I argued that certain sorts of corporate obligations could be understood simply as requirements of fairness. So in much the same way that manufacturers have a responsibility to produce safe products for consumers, corporations have a *prima facie* responsibility to increase returns for shareholders. Importantly, however, this responsibility is defeasible, and if corporations give fair warning to investors, there is no reason why they could not, as independent enterprises, seek to pursue other goals besides maximizing returns for shareholders.[22, 23]

[22] ["Investor," 29 ends.—Eds.]

[23] ["To know what a practice requires, you have to formulate the underlying goals, aims and purposes that the practice is supposed to serve, and then specify the requirements of the practice so that they serve these ends. The interpretation of the underlying goals, aims and purposes, as well as the specific requirements, should fit with how participants behave and make the practice as worthy of people's compliance as possible" (Hussain and Sandberg 2017, 5).—Eds.]

8.3. Agency, Freedom, and the Invisible hand

The point of laying out the social governance conception of the market[24] is to orient our thinking about freedom in the right way.[25] Once we think of ourselves as fully realized citizens in a liberal democracy who participate in the institutional practices that constitute an advanced market economy, many questions come more clearly into focus. But I want to [summarize] the central issues by illustrating why an advanced market economy raises special questions with respect to freedom.

As I noted earlier, a stable liberal democracy consists of a very large number of individuals, each with her own life.[26] We can think of each individual's life as consisting, in part, of activities in which the individual thinks and acts according to a set of rules. For any individual *i* call the set of rules that regulate her thought and conduct *Li*. If we look at some particular person *p, Lp* will consist of a wide array of rules, including not only the rules that *p* follows in her own home but also the rules that she follows on the road, in productive activities at work, in the search for a job, on the playground, walking across a field, etc.

In any stable society, many rules are intersubjectively recognized; i.e., the same rules will form part of *Lp, Lq, Lr, . . . Ln*. Among these intersubjectively recognized rules will be the rules of property. Consider a famous example from G. A. Cohen (2011b). Cohen notes that if I try to pitch a tent in your backyard without your permission, you could call the police to have me removed.[27] For Cohen, the example highlights how private property provides certain options to those who own a resource, while at the same time taking certain options away from those who do not own it. But the example also nicely illustrates how private property—or any form of property—involves social rules that apply to everyone (see Scanlon 1976, 2011). These rules apply to those who own a piece of property as well as those who do not. Furthermore, the example also draws attention to the fact that, in the normal case, most people are not actually pitching tents in your backyard without your permission. This is because most members of society think and act according to the same (or very similar) rules with respect to property. Even

[24] [Namely, a conception of the market which supplements "the regulatory process and democratic legislative process with social governance mechanisms" that satisfy the Kantian ideal of respect. See section 6.7.—Eds.]
[25] ["Governance," penultimate paragraph, 24 starts.—Eds.]
[26] [See especially section 1.3.—Eds.]
[27] [Cf. section 3.5.—Eds.]

the homeless population, by and large, understands the rules of property and conforms to these rules as they each search for shelter and busk for change.[28]

As a political value, freedom is best understood as a kind of social ideal. Governance systems live up to this ideal when they are structured so as to put each person in a position to adhere freely to the rules that govern her life.[29] For *p* to adhere freely to *Lp*, she must have a reflective understanding of the objective reasons that tell in favor of her adhering to these rules, reasons that may involve public values or private ones (see chapter 1). When an individual has a proper understanding of these underlying reasons, no external forces govern her conduct and she is fully in control of her activities.

The market, as we have seen, is a governance system. It is a dynamical interaction system that constantly arranges and rearranges the portion of each citizen's *L* that corresponds to the coordinating rules of economic life. An advanced market economy constantly adjusts the rules so as to maintain a configuration that is Pareto optimal. It achieves this, in part, by constantly putting individuals in choice situations where the option that advances the individual's self-interest will bring the coordinating rules back to a Pareto optimal configuration. In this way, the market exerts a kind of control over how people think and act in their everyday lives, constantly drawing people into a certain pattern of activity. But whether the market is consistent with the ideal of freedom depends on the way that it draws people into the relevant patterns.[30]

A governance system[31] respects the value of freedom when it puts people in a position to comply with coordinating rules in economic life from a reflective understanding of the objective reasons that tell in favor of adhering to these rules. But an advanced market economy is a system that draws people into certain patterns of activity automatically, without being sensitive to the full range of relevant considerations and without putting people in a position to make their own judgments.

An advanced market economy is, in a way, analogous to a pool of quicksand. We usually think of violations of the ideal of freedom in terms of

[28] This is not to say that the rules of property are justified; it is only to emphasize that the rules of property are among the rules that members of a stable liberal democracy follow in their everyday lives.

[29] This ideal is closely related to a Kantian ideal of mutual respect, according to which we must structure our conduct toward one another in ways that put those affected by our actions in a position to judge for themselves whether to accept or reject the maxims on which we act (i.e., the maxims which we assert as universal laws). See Rawls 1999, 297; O'Neill 1985.

[30] ["Governance," 26 top paragraph ends.—Eds.]

[31] ["Governance," 28 mid-paragraph starts.—Eds.]

putting people in jail cells, where their bodily movements are confined. But there is more than one way to imprison people. When we each do our part to maintain a market arrangement, we put one another in a situation where our activities will be continuously drawn into certain patterns, without reference to our full range of judgments about value. This situation is inconsistent with the ideal of freedom, not because we confine one another's bodily movements but because we continuously draw people into certain patterns of activity, regardless of their own judgments. Much like quicksand, a market arrangement disables people in a certain way rather than confining them in the most obvious sense.

The line of reasoning I just laid out is meant only to introduce the issues. My point is to explain why the market raises certain distinctive questions about freedom. The proper response is to embed markets in a wider system of political governance that monitors the market process and channels market coordination in ways that are consistent with public values and the judgments that citizens make about these values. The central question is about the right form that these wider institutional arrangements should take. We cannot simply assume that the right structure of political governance is one that concentrates political judgment and decision-making in a formal legislative and regulatory process that unfolds "outside" of the market sphere.

There are two reasons for rejecting a mechanism that relies exclusively on citizens regulating market activity from the outside. First, an arrangement along these lines effectively establishes a *default* mode of social coordination that favors allocative efficiency and growth over other political considerations. But a coordination mechanism that establishes these trade-offs as the default may be difficult to channel in ways that are sensitive to other considerations. For instance, (a) political constituencies that benefit from the patterns of activity that the market generates may resist policies that address various political concerns through *ex post* redistribution and intervention (Lindblom 2001; O'Neill and Williamson 2012); (b) the information necessary for effectively monitoring market coordination on a continuous basis may be lacking, particularly with respect to the distribution of profits within business corporations (Piketty 2014); and (c) in cases that involve developing technologies, such as genetically engineered food or genetically modified babies, there may be no way of going back once the genie is out of the bottle.

Second, living a life directed by corporate authority, prices, and competitive selection is, in an important way, to live a life that is not guided by your own judgments about what you have reason to do. Market institutions effectively put citizens in a day-to-day situation that requires them to act with a kind of blind faith in market coordination. In this respect, a market society is similar to a religious community that demands that its members follow certain rules without understanding the reasons behind these rules. Even if we could embed market institutions in a political governance mechanism that channels the process in the right way from the outside, the arrangement would still fail to answer to an important dimension of the ideal of freedom. A society that fully respects this ideal must design its institutions to be transparent, whenever possible, and to require only reasonable forms of trust in the system.

Taking the two points together, my argument aims to provide a rationale for a particular kind of political governance structure for a market society. The structure that I defend—i.e., intermediated capitalism—does not concentrate political judgments and political decision-making exclusively in legislative and regulatory mechanisms that operate outside of the market sphere, as we ordinarily understand it. Respect for the value of freedom requires a structure that incorporates certain forms of political judgment and decision-making within the market sphere itself. Among the relevant forms of political governance, we can include a code of ethics for professionals (e.g., lawyers, doctors, safety experts), labeling schemes and other forms of ethical consumerism (see Hussain 2012a), and "triple bottom-line" accounting practices. The relevant forms of political governance may also involve a governance structure for business corporations that puts workers in a position to participate in making significant decisions, along with managers and shareholders, about how to structure production within a firm and how to structure competitive conditions within an industry more generally. This last mechanism, a variation on the German codetermination system, will be the main focus of [what follows].[32]

8.4. An Intermediated Market Arrangement

What would an advanced market economy that satisfies the Kantian ideal of mutual respect[33] look like? An "intermediated market arrangement" is

[32] ["Governance," 29 ends.—Eds.]

[33] [That is, a market system that draws people into its patters by "being sensitive to the full range of relevant considerations and [by] putting people in a position to make their own judgments."—Eds.]

one example. An intermediated market arrangement is a type of advanced market economy, so its rules incorporate certain familiar features, such as private ownership, competitive markets, and various rules that define the business corporation. But what makes an intermediated market arrangement different is that its rules are designed to do two things that other advanced market economies do not:

1. The rules foster the formation of a limited number of secondary associations to represent the perspectives of major segments of the population in various rule-making forums.
2. The rules ensure that changes to the rules of economic competition come about through a process of deliberation and reasoned agreement among the relevant associations in appropriately situated rule-making forums.

Under an intermediated market arrangement, there would be a limited number of encompassing associations in each industry or sector of the economy to officially represent the perspectives of various groups who participate in production (e.g., workers and owners), as well as other relevantly affected parties.[34] These associations would meet regularly to establish the parameters for competition between corporations. The process of establishing these parameters would be one in which representatives deliberate rather than bargain; i.e., instead of negotiating strategically to further the interests of their constituents, parties would cooperate with each other to find standards and polices that all could accept as an appropriate framework for competition in a properly ordered political community.

The German codetermination system provides an imperfect but helpful real-world illustration (Addison 2009; Charkham 2005; Vitols 2001; Wiedemann 1980).[35] German corporations share certain general features with their American counterparts, such as a two-tiered structure.[36]

[34] [Including extra-firm organizations, such as unions and civil society organizations. Hussain called these bottom-up institutions "the shock troops of economic democracy."—Eds.]

[35] [Hussain suggests that codetermination is only one form of intermediated market arrangement, one that helps attenuate the problem of the judgment-bypassing character of these arrangements by dint of (1) and (2).—Eds.]

[36] American corporate governance is often described as a "unitary" rather than a "two-tiered" structure. This is because executive officers in an American corporation will often also hold positions on its board of directors. By contrast, the German system is "two-tiered" because the supervisory board in a German corporation is fully independent of its executive board, with no one holding positions in both bodies. The American corporate governance arrangement is like the English

Shareholders invest in a corporation by purchasing shares, and in return they get a right to a dividend and a right to vote for supervising directors. Members of the supervisory board appoint, dismiss, and supervise members of the executive board. Executive directors, in turn, form an executive board that assumes full responsibility managing the day-to-day affairs of the company.

German corporations differ from their American counterparts, however, in terms of the structure of the supervisory board. Under the codetermination law, German corporations with more than 2,000 employees must reserve half of the seats on their supervisory boards for worker representatives. To take a real-world example, Daimler AG, the parent company of Mercedes-Benz, is a large corporation (over 270,000 employees worldwide) and has a supervisory board of 20 members. Of these 20 members, 10 represent workers: six are drawn from work councils within the company, three from major trade unions, and one from among salaried managers. Along with shareholder representatives, labor representatives vote on a range of corporate policy issues, including the hiring and firing of executive officers.

At the same time, the codetermination system empowers industry-wide unions, such as IG Metall and IG Chemie, to bargain on behalf of all of the workers in their respective industries and to appoint representatives to the supervisory boards of all of the large corporations in them. These powers enable unions to engage manufacturing associations in bargaining processes that establish the ground rules for economic competition between corporations in an industry. These ground rules cover a range of issues, including compensation, pensions, work hours, job training, and worker retention.

According to the codetermination law, decisions on the supervisory board of a business corporation are governed by majority rule, and in the event of a tie, the chairperson has a second vote. Since the chairperson is elected by shareholders, this second vote ensures that representatives of capital investors retain ultimate control over corporate decision-making. But looking at the structure of the German corporate form as a whole, particularly in comparison to the Anglo-American model, the arrangement is clearly structured to ensure that corporations are responsive to the outlooks of many affected groups, including both capital and labor. The codetermination system also takes a range of steps outside of the corporation to ensure

Parliamentary system, where the prime minister and other executive officers (i.e., cabinet ministers) are also members of Parliament.

that the coordination of production activity in society is responsive to the felt concerns and interests of different groups.

For the codetermination system to fully realize the model of an intermediated market arrangement, all of the representative associations involved would have to be transparent and representative of their memberships, and the decision-making process in each rule-making forum would have to take the form of deliberation rather than mere bargaining. Moreover, the deliberation involved would have to consider a full range of social and political values that bear on the pattern of production activity in the relevant industry or sector of the economy.[37, 38]

8.5. Reason Sensitivity

An advanced market economy with business corporations is a judgment-bypassing social coordination mechanism: the arrangement maintains a society-wide pattern of production activity and consumption activity that is economically efficient, and it does so in a way that bypasses the judgments of

[37] It is interesting to note in passing how the rationale for the codetermination system is understood by at least some officials in Germany. In 2005, the German government set up the Biedenkopf Commission to reassess the codetermination law. According to the final report issued by the academic members of the commission, an important aspect of the justification for this arrangement is *not* a matter of economic efficiency: "[T]he goal of the 1976 Co-determination Act was not to improve company competitiveness, but rather to provide employees with a democratic voice in company decisions that affected them. The reason for board level representation is that a company is to be understood as a social group, in which the owners, company management and employees work together with a common purpose" (Hans Böckler Foundation 2007, 3).

The expressed justification of the codetermination system is quite different from the rationale that lies at the foundation of economic theory of the corporation. The economic theory takes it for granted that labor is just another factor of production. It assumes that decisions about how to use labor should be made in much the same way as decisions about other factors of production, such as machinery or raw materials. But the expressed justification for codetermination recognizes that labor is different. When the corporation brings workers into the production process, it is bringing them into a relationship with managers and shareholders. This relationship can be authoritarian or it can be cooperative, and the codetermination system is premised on the idea that it should be cooperative. By contrast, there is obviously no question of bringing a bag of cement or a hard drive into a relationship with other participants in corporate activity. In this way, the codetermination system is based on a partial rejection of the commodification of labor and on the recognition that corporate governance should be sensitive to other values besides efficiency. [It also contrasts with the fiduciary conception discussed above.—Eds.]

[38] ["A social practice is a collective enterprise that makes of an array of demands on participants, where participants may or may not have good reason to comply with these demands. We follow Ronald Dworkin (1986) in thinking that the requirements of a social practice are not determined by brute sociological facts. From the point of view of participants, the requirements of a practice are meant to serve some underlying goal, aim or purpose, one that is related to some deeper value or values" (Hussain and Sandberg 2017, 5).—Eds.]

members about the merits of the pattern. In order for an arrangement of this kind to be consistent with the Kantian ideal of mutual respect, it must satisfy three requirements: reason sensitivity, transparency, and trustworthiness.[39] It would take an extensive argument to show fully that an intermediated market arrangement could meet these requirements, but I want to offer a partial illustration here.

Consider reason sensitivity. Among the factors that determine whether we have good reason to engage in a certain pattern of production activity and consumption activity is distributive justice. Over the past 20 years, liberal market democracies have seen an enormous increase in overall levels of income inequality, and this is due in part to a significant increase in the overall level of executive compensation in publicly traded corporations (Piketty 2014). There is also an overall tendency toward an increasing share of total social income being paid out as returns to capital rather than labor income (Piketty 2014). One way that an intermediated market arrangement could exhibit greater reason sensitivity than other types of advanced market arrangements is by addressing these forms of distributive inequality and drawing us into a more just overall pattern of production and consumption.

How might an intermediated arrangement do this? One way is simply by creating greater access to information. Income from production in the corporation must be divided between shareholders (e.g., dividends), managers (e.g., wages, stock options), and workers (e.g., wages and benefits). Many things that happen in the boardroom can affect how income from production gets divided: accounting methods, social networking, the structuring of long-term contracts, control over financial disclosures, various forms of self-dealing, etc. Much of the process is unobserved and poorly understood, both by workers and by the wider public, and the financial press is often unable or unwilling to conduct the kind of investigation that is necessary to understand what is going on.

In an intermediated market arrangement, encompassing associations that represent the standpoint of workers will have access to the corporate boardroom. These organizations will have more resources and a greater motivation to determine how income from production is being divided in the firm and whether the division is justified. This is important both in terms of structuring salaries, stock option, and benefits for corporate managers, and

[39] [See chapter 5.—Eds.]

in terms of determining the proportion of overall income from production that gets assigned to workers as wages and benefits.

Another important way that an intermediated market arrangement can manage income inequality is simply by having worker representatives in the boardroom to contest the claims to compensation made by executives. When Jack Welch, former CEO of General Electric, defends his $417 million severance package, he can make the argument that, under his watch, GE grew from a company worth $14 billion to one worth $410 billion. But in an intermediated market arrangement, there would be worker representatives in the room to point out that GE has over 283,000 employees, including some of the brightest and most inventive engineering minds in the country—as well as Jerry Seinfeld and Larry David, who both worked for NBC when it was owned by GE. Surely these people had *something* to do with GE's success. Over the past 20 years, Germany has done a better job, in general, of keeping CEO compensation under control, as compared to the United States and the United Kingdom. Though there has not been extensive research into the reasons why, it is reasonable to think that it harder for CEOs to make claims about the compensation they deserve when worker representatives are sitting across the table in the boardroom.

Finally, consider a set of problems that stem from competition. One danger in leaving compensation issues purely within the realm of market competition is that there is a danger that if workers are in a weak bargaining position, the industry may find itself in a "race to the bottom." In the case of worker pensions and retirement programs, for example, there has been a huge change in the United States over the past 20 years. Large corporations can underfund or eliminate pension programs for workers as a way of funding investments in production. When one corporation in an industry has success with a pension strategy of this kind, other market players will find that they must take similar measures to remain competitive. Pension and retirement costs are a huge factor in overall labor costs in the automotive industry, healthcare, and other areas. One of the most attractive features of outsourcing and other ways of reclassifying workers is precisely to lower labor costs by avoiding having to pay into a 401(k) or some other retirement scheme.

A key feature of an intermediated market arrangement is that it creates an avenue for encompassing associations to work out rules that structure and control the competitive market process at the level of an entire industry. Again, taking the example of German codetermination, one of the issues that encompassing associations in the automotive industry have to address is basic rules that govern pensions and other forms of compensation. Because manufacturing associations and labor associations work out the basic rules that structure competition in the industry, they can step out of the market competition process in order to draw the process as a whole toward patterns of production activity and consumption activity that are more distributively just (because overall compensation for workers is better).

8.6. Some Issues to Think about in Developing the Model

Of course, there is much more to say about these issues; I have offered here only one small illustration of how an intermediated market arrangement could satisfy one of the basic requirements of mutual respect that I outlined in the previous section: reason sensitivity. There are many other issues to address. But let me add a few final thoughts about the basic sketch.

(a) I have focused on worker associations, but as I understand it, an intermediated market arrangement would also foster the formation of environmental associations and consumer associations to participate in various rule-making forums.
(b) Rules that are the outcome of deliberative processes at the level of industries or sectors of the economy would always be subject to the oversight of the formal democratic political process. The point of these subordinate rule-making forums is to extend the reach of deliberative governance further into the market, and for deliberative governance to be faster, more responsive to market developments, and better informed.[40]
(c) Intermediated market democracy will face various "agency problems." Once workers elect representatives to participate in the decision-making process, these representatives may come to share interests with corporate insiders. This might lead worker representatives to act on these "insider" interests rather than represent the perspective

[40] ["Democratic intermediation improves the reason-sensitivity of the market process by making it more sensitive to the reasons that workers have for participating in certain forms of production. At the same time, collaborative reasoning, deliberation and monitoring helps to disperse information, making clearer to workers how various changes track or fail to track the relevant underlying considerations. These measures improve transparency. The codetermination system is a model for respecting freedom in market societies" (8).—Eds.]

of workers in deliberation—the 2008 bribery scandal at Volkswagen might serve as an illustration. But it is important to keep in mind that *any* system that requires one set of agents to represent the interests of another faces similar problems; we see agency problems of a similar kind arising with respect to corporate executives and to legislators in the US Congress. Much as any other representative system, an intermediated market arrangement will have to take an array of familiar measures to address these issues.

(d) As far as possible, an intermediated market arrangement should be transparent and public. Deliberations among representatives in different rule-making forums should be publicized and easily accessible to employees, shareholders, and citizens more generally. As is the case now, deliberations at the level of a corporate supervisory board might be broadcast over the web or available through some subscription service. All those involved in production or whose activities might be affected by the outcome should be able to hear the evidence presented to representatives and the arguments they make to one another. The presentation of information and arguments then provides a basis for citizens to understand the overall pattern of economic activity they are being drawn into and the reasons that justify the pattern.

8.7. Summary

On my view, the market is a dynamical interaction system.[41] Rather than a series of one-off interactions, an advanced market economy is a complex institutional structure that shapes the choice contexts of individuals and consistently draws them into certain patterns of activity. But a dynamical interaction system is not a natural phenomenon in the way that bird migration or fluid mechanics is a natural phenomenon. Market actors are citizens, just like you and me, and they have a full range of personal, social, and political convictions. The market raises special questions about freedom insofar as it draws people into particular patterns of activity, but does so in a way that does not properly *address* market actors as agents who have their own point of view.

[41] ["Governance," 30, bottom paragraph starts.—Eds.]

An intermediated market arrangement is a type of advanced market economy, so its rules incorporate certain familiar features, such as private ownership, competitive markets, and various rules that define the business corporation. But what makes an intermediated market arrangement different is that its rules are designed to do two things that other advanced market economies do not: (a) the rules foster the formation of a limited number of secondary associations to represent the perspectives of major segments of the population in various rule-making forums, and (b) the rules ensure that changes to the rules of economic competition come about through a process of deliberation and reasoned agreement among the relevant associations in appropriately situated rule-making forums.

Under an intermediated market arrangement, there would be a limited number of encompassing associations in each industry or sector of the economy to officially represent the perspectives of various groups that participate in production (e.g., workers and owners), as well as other relevantly affected parties. These associations would meet regularly to establish the parameters for competition between corporations. The process of establishing these parameters would be one in which representatives deliberate rather than bargain; i.e., instead of negotiating strategically to further the interests of their constituents, parties would cooperate with each other to find standards and polices that all could accept as an appropriate framework for competition in a properly ordered political community.[42]

[42] [See pp. 160–64 above.—Eds.]

Conclusion

Lockeanism is the dark matter of Anglo-American political thought. Locke's vision of the individual and her place in the world exerts a constant gravitational pull on how we think about society. Whenever we reach for the most fundamental description of our social predicament, a starting point for political reflection, we seem to start with a conception of ourselves as persons with material bodies who interact with the natural world. Other members of society are also persons with material bodies who interact with the natural world. Economic life is substantially a matter of transforming the world through our labor and moving the objects that we create from person to person until they end up in the hands of someone who will consume them. The most fundamental moral issues are about assault, coercion, and theft.

Throughout this book, one of my central aims has been to push us out of this Lockean mindset, particularly when it comes to thinking about the economy. We are more than just material bodies interacting with each other in the natural world. We are thinking creatures, subject to the most fundamental rules of thought and conduct. We are also members of a society: we coordinate our activities with one another within a shared framework of rules for thinking and acting. Without a shared framework of this kind, closely related to language, it would be impossible for millions and millions of people in countries around the world to interact with each other in a mostly peaceful and productive way every day.

From the moral point of view, assault, coercion, and theft are not the most basic concerns. In fact, all three are aspects of a more fundamental moral concern, namely mutual respect. Morality requires that we respect one another as creatures who have a fundamental capacity to lead our own lives in light of our own practical judgment. From this standpoint, assault, coercion, and theft are all objectionable, at a more fundamental level, because they are violations of this requirement of mutual respect.

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Starting with this more fundamentally social picture of our social predicament, we can formulate a much more realistic conception of the morality of economic life. The market is a social institution whose basic rules are encoded in the law. The purpose of the market is not fundamentally to provide people with a domain of private individuality. That purpose is served by a fully adequate scheme of basic liberal freedoms, including the freedom of thought, conscience, expression, religion, personal property, and the person. This list of liberal freedoms need not include any of the more extensive rights of ownership, accumulation, and exchange that are central to a market economy. The point of a market arrangement is not, therefore, to provide people with a sphere of liberal freedom, but rather to coordinate economic production and consumption in society. The market is a way of getting ourselves organized to produce things and consume things in the right way.

The market is a mechanism of social control. It embodies a structural assertion of collective authority in that we collectively maintain the market for the purpose of, among other things, maintaining an economically efficient pattern of production and consumption. The market operates by transforming our market activities into a dynamical system, where an economically efficient pattern of production and consumption is (at least under ideal conditions) the stable equilibrium point of the system. Whenever there is a shock to the system that pushes us off the efficiency frontier, a cascading series of adjustments to each person's option set will eventually lead everyone back into a pattern of production and consumption activity that is economically efficient.

But a dynamical interaction system is not a natural phenomenon in the way that bird migration or fluid mechanics is a natural phenomenon.[1] Market actors are citizens, just like you and me, and they have a full range of personal, social, and political convictions. The market raises special questions about freedom insofar as it draws people into particular patterns of activity but does so in a way that does not properly *address* market actors as agents who have their own point of view.

An intermediated market arrangement is a type of advanced market economy, so its rules incorporate certain familiar features, such as private ownership, competitive markets, and various rules that define the business corporation. But what makes an intermediated market arrangement different is that its rules are designed to do two things that other advanced market

[1] ["Governance," bottom paragraph, p. 30 starts—Eds.]

economies do not: (a) the rules foster the formation of a limited number of secondary associations to represent the perspectives of major segments of the population in various rule-making forums, and (b) the rules ensure that changes to the rules of economic competition come about through a process of deliberation and reasoned agreement among the relevant associations in appropriately situated rule-making forums.

Under an intermediated market arrangement, there would be a limited number of encompassing associations in each industry or sector of the economy to officially represent the perspectives of various groups who participate in production (e.g., workers and owners), as well as other relevantly affected parties. These associations would meet regularly to establish the parameters for competition between corporations. The process of establishing these parameters would be one in which representatives deliberate rather than bargain; i.e., instead of negotiating strategically to further the interests of their constituents, parties would cooperate with each other to find standards and polices that all could accept as an appropriate framework for competition in a properly ordered political community.

APPENDIX

What Is a Market Economy?

The market is a centrally important institution in modern social life. But theoretical discussions in political philosophy and economic ethics often work with a somewhat vague idea of what the market is. The most common conception is that the market is simply a domain in which people exercise their private property rights, independent of any direct interference from the state. Property rights may be natural or conventional, but either way, the market is a sphere in which individuals have authority over their labor and their property, and they make their own decisions about what to do with their time and their possessions (see Nozick 1974; Hayek 1960; Friedman [1962] 1982).

Unfortunately, the property rights view is fundamentally flawed. This is because the market involves a distinctive mode of reasoning, and you cannot understand what the market is without paying special attention to how people are supposed to think about what to do in market contexts (see Lindblom 2001; Dahl and Lindblom 1992; Sen 1984b).

The clearest illustration of the problem is the family. My own family consists of myself, my wife, and our two children. We are all involved in an ongoing pattern of interaction that includes, among other things, a pattern of production activity (e.g., making breakfasts, lunches, and dinners) and a pattern of consumption activity (e.g., eating breakfasts, lunches, and dinners). My wife and I have private ownership over the resources involved in these activities: we each own our own labor power; we have private ownership in our condo; and we own all of the various material resources in our cupboards. The state does not own any of the relevant material goods, and it does not exercise direct authority over any of the individuals in our household. Nevertheless, *our family is clearly not a market.* Neither is our family an extension of the wider market in our community. Though it belongs to the domain in which people exercise their private property rights independent of any direct state interference, there is clearly something about the family that makes it different from the market.

Looking at my own family, the most obvious difference is that the coordination of production and consumption proceeds very differently in our household as compared to the way that it does in the market. My wife and I do not treat our children the way that we treat our employers. If we demanded payment from our children to make it worth our while to cook and clean for them, they would be in *big* trouble. Our 10-year-old and 7-year-old have very little property and very little bargaining power, so there is very little that they could offer us to make it worth our while to care for them. If we treated them strictly in the way that we treat our employers, our kids would likely die from starvation and neglect (at least without some nonmarket intervention).

Thankfully (!) our kids are not starving or neglected. The reason is that the rules of family life require my wife and me to provide for our kids' basic needs, and we see ourselves as having an obligation to live up to these requirements. In fact, everyone in our household recognizes these rules, including our kids, and we all recognize a range of other rules that determine how we should think and act with respect to one another's basic needs. The family is different from the market because production and consumption in the family is not coordinated through a process of bargaining and exchange between fully separate, mutually disinterested agents (i.e., "arm's-length" bargaining).[1]

Any adequate conception of the market must capture the central importance of mutual disinterest to this social form. In this appendix, I will set out a more rigorous conception of the market that does just this. Call this the *institutional model*. The model builds on the seminal work of Charles Lindblom (Lindblom 2001; Dahl and Lindblom 1992), though I add and subtract elements from Lindblom's account to bring mutual disinterest into focus. The institutional model ultimately does a better job than the property rights model in explaining the similarities and differences between the market and a range of other social forms, including: families, bureaucracies, firms, Wikipedia, open source software, scientific inquiry, conversation, the "marketplace of ideas," public utilities, net neutrality, feudalism, courts, legislatures, ticket lines, and so on.

A key feature of the institutional model is that it assumes a broadly Kantian conception of practical reason (see Kant [1785] 1996, [1797] 1996; Hart 1984; Rawls 1999; Habermas 1996; Korsgaard 2008; O'Neill 1985; Scanlon 1998). According to this conception, there are general rules and principles that define good practical reasoning, and these rules and principles determine what course of action a given individual should pursue in a given set of circumstances. Importantly, the rules and principles of good practical reasoning may direct people to pursue their own self-interest to the exclusion of other considerations, but they may also require people to act on the basis of other considerations besides self-interest. The key point is that *the rational pursuit of self-interest is not basic on this conception*—even in economic life. The pursuit of self-interest is just a particular form of reasoning that people may be licensed to engage in in certain contexts by other rules and principles that are more fundamental. This deontological or "norm-based" conception of practical reasoning may seem alien to readers who view economic life mainly through the lens of microeconomics, game theory, and related disciplines. But this conception is central to the view of economic life from the perspective of sociology, anthropology, political science, and the law.

In what follows, I set out eight features that distinguish a market economy from other social forms. The first six features define what I call a *basic bargaining system*, the most barebones idea of a market that covers everything from a Turkish bazaar to kids trading baseball cards on a playground. All eight features together define a *market economy*, which is a basic bargaining system whose rules are structured to create a society-wide mechanism of social coordination, one that shapes social patterns of production and consumption.

Here are the eight features of a market economy:

A Market Economy
1. Independent actors
2. Private ownership

[1] Some people take the extreme view that even families are markets because family members are led by incentives and bargaining to comply with the rules of familial interaction. This is certainly a view that you could take. But if even the family is a market, then it seems that *almost every social form* is a market—even bureaucratic central planning would be a market because participants are led through incentives and bargaining to comply with the rules of bureaucratic interaction. At this point, anyone who holds the extreme view would have to introduce some new distinction between social forms in order to address important normative questions, such as the following: When (if ever) should we use markets? When (if ever) should we use central planning? When (if ever) should we have families?

3. Private transfer
4. Authorization to pursue self-interest
5. Mutual disinterest (*quid pro quo*)
6. Authorization to act against the interests of others
7. Production for sale
8. Mediated consumption

I should note that a market economy, as I understand it, is different from "capitalism." The eight features listed do not mention entrepreneurs or business enterprises (cf. Lindblom 2001), so an arrangement may constitute a market economy in my sense even if there are no "capitalists"—i.e., no actors who seek exchange value for its own sake. Similarly, the eight features do not mention an inner drive to accumulate investment capital for its own sake (cf. Marx 1967), so an arrangement may constitute a market economy in my sense even if there is no such drive built into the system. A market economy is a more abstract concept than capitalism: a market economy may have capitalists or an inner drive to accumulate investment capital, but this is not necessary. The more abstract concept allows us to consider a wide range of market arrangements, including various forms of "capitalism," and assess these on normative grounds.[2]

A market economy is also different from an "advanced market economy," which is the concept that figures most prominently in the main argument of this book. The central difference is that an advanced market economy incorporates a certain public justifying rationale for the enterprise and a bureaucratic apparatus whose role is to ensure that the arrangement serves this justifying rationale. I focus here mainly on the simpler notion of a market economy in order to bring the key issue of mutual disinterest into view. In section A.3, I will add the two distinctive features to the general account of a market economy and present a formal account of the concept of an "advanced market economy."

A.1. A Type of Social Institution

Recall from the introduction that a social institution is an abstract scheme of rules (and sometimes principles) that specifies how the members of a community should think and act, where each member has an obligation to adhere to the scheme in part because the other members are adhering to it as well (Hart 1997; Dworkin 1986; Rawls 1999, 293–308; Scanlon 1998, 339–40; see also Habermas 1984, 1996). In the case of a parking lot, drivers typically share an understanding about where people may park their cars and who has the

[2] There are many ways to think about the distinctive pattern of social organization that emerges in western Europe sometime in the 16th century and has come to be dominant in the world today. In *Capital*, Marx typically identifies capitalism either with an institutional arrangement whose inner dynamic is geared toward accumulating profits for its own sake (Marx [1867] 1967) or with an institutional arrangement whose inner dynamic constantly reproduces a relationship among an ownership class and a proletarian class. Weber (2010) and Schumpeter (1942) each have their own widely discussed views (for an overview, see Kocka 2016). Some market arrangements may not be capitalist; e.g., a property-owning democracy, as Rawls describes it, would not be capitalist in Marx's sense because it would neither increase profits for their own sake nor re-create the relation between capitalists and proletarians. It is an open question whether such a property-owning democracy could really be stable over time or whether it would collapse into some form of capitalism. I take this to be an important question that would form part of a normative assessment of different types of market arrangements.

right of way, and part of the reason each driver has an obligation to adhere to the shared understanding is the fact that the other drivers are adhering to it as well.

According to the institutional model, a market economy is a social institution, not unlike the parking lot. A market economy consists of a scheme of rules that specifies how members of a community should think and act in certain circumstances, where each member has an obligation to adhere to the scheme in part because the other members are adhering to it as well. The main difference between a parking lot and a market economy is that the rules of a market economy have a different structure and apply in a much wider range of circumstances.

In setting out the constituent elements of the rule structure that makes up a market economy it will help to recall a few general features of social institutions. Among other things, (a) institutions can define various statuses and positions, with rights, duties, and powers attached; (b) institutions can define various procedures that determine how people acquire and lose the statuses and positions it defines; (c) institutions can define institutional powers that allow people to change the first-order requirements of the institution; and (d) institutions can define the legitimate grounds on which people can exercise the institutional powers it defines.

An added point will be helpful for the discussion. When an institution defines the legitimate grounds for exercising an institutional power, these grounds may be articulated in terms of requirements that are either *substantive* or *procedural*. Substantive requirements set out certain types of considerations that actors may take into account in exercising a power, while procedural requirements set out certain forms of consultation that actors must go through before exercising a power. In the case of a parking lot, drivers may be authorized to occupy parking spots based only on use value considerations—this is a substantive requirement. In residential parking lots, visitors may be authorized to occupy a parking spot only on the condition that they have written permission from the building manager—this is a procedural requirement.

Although I treat the market economy as a social institution, I want to allow for my institutional account to have wider scope. From the moral point of view, a market economy is, in the first instance, a scheme of rules that the members of a community could adopt as the content of a shared understanding about how they are supposed to think and act. But some thinkers might hold that the abstract scheme of rules that I describe is not a social institution but a feature of natural law. When a scheme of rules is part of natural law, the members of a group may have reason to comply with the scheme, but these reasons are not tied necessarily to the fact that other members are complying with the scheme as well. Instead, the rules form a normative order that applies to all individuals in a community, whether or not there is a settled practice of compliance. For instance, Locke ([1698] 1988; see also Nozick 1974) holds that the various rights of private ownership, acquisition, and exchange are parts of a natural law. Human beings have these rights and powers even in the state of nature, where there are no settled institutions.[3] The various elements that

[3] Some theorists (Locke [1698] 1988; Nozick 1974) view settled institutions and legal systems as justified only to the extent that they could be derived from pre-institutional rights that people would have according to natural law in a state of nature. Rawls (1999) and Scanlon (1976, 2011) hold that individuals have certain natural rights and duties that apply to them independently of the existence of settled institutions (e.g., the duty of mutual aid). But Rawls and Scanlon reject Locke's view that settled institutions are derived from an exercise of these institution-independent rights, duties, and powers. Instead, they view institution-dependent and institution-independent rights, duties, and powers as each deriving separately from a more fundamental contractualist conception of morality (see also Nagel 1991).

I set out below as essential features of a market economy apply, I believe, to any abstract scheme of rules, so these requirements would extend not only to the market economy understood as a social institution but also to a market economy understood as a feature of natural law.

A.2. Defining Features of a Market Economy

A market economy is a scheme of rules, a system of practical reasoning that is meant to determine how the members of a community think and act in a certain set of circumstances. The following eight features together distinguish a market economy from other types of social forms.

A.2.1. Independent Actors

The rules of a market economy will define a status for official actors in the arrangement. Those who hold the status of "market actor" can exercise the powers defined by the institution and acquire right, duties, and powers within it. Market actors are distinct units who can acquire rights, duties, and powers independently of each other. Moreover, they are capable of interaction, as one market actor's exercising her powers can affect the rights, duties, and powers of other market actors. A market economy need not extend the status to all adult human beings: under chattel slavery, some human beings are assigned the status of "property" rather than "market actor." A market economy may also extend the status to artificial entities, such as business corporations or estates, where these artificial entities exercise market powers and interact with other market actors through the actions of natural persons.

A.2.2. Private Ownership (Including Ownership of Labor Power)

A market economy defines the power of private ownership. We can think of this as the power to assume a certain status (i.e., "owner") with respect to an object, where this status consists of an array of more specific rights and powers. Among these more specific rights and powers are (see Honoré 1961) the right to possess the object (i.e., to have physical control over it and to have it returned); the right to use the object; the right to exclude others from using it; the right to transform the object; and the right to consume, waste, or destroy the object. For the sake of simplicity, we can include within the scope of private ownership the power to assume a certain kind of decision-making authority with respect to the labor of a human being, whether an actor's own labor or the labor of others.

What makes the power of private ownership "private," in the first instance, is the way that market actors are authorized to exercise the constituent rights and powers. In the standard cases, these rights and powers are not subject to any procedural requirement such that market actors must consult with others about how they will exercise these powers. If I have private ownership of my house, this implies, among other things, that

I can decide who will have access to it; I don't have to consult with my neighbors or with political officials when deciding whom to allow inside.

A.2.3. Private Transfer

The rights and powers of ownership are attached to a particular status (i.e., "owner") with respect to some material object or some form of labor. The rules of a market economy empower market actors to transfer this status from one actor to another (or to transfer some of the constituent rights and powers). The power of transfer covers aspects of what Honoré (1961) calls the "right to manage," the "right to the income," and the "power to alienate."

As in the case of private ownership, what makes the power to transfer "private" in the first instance is that market actors may exercise the power without consulting with other actors. In a market economy, two market actors A and B can transfer ownership of some asset from A to B without having to consult with any other market agents, so long as A and B are in agreement. Private transfer constitutes a power for market actors to change their statuses with respect to various objects without having to consult with other agents or the wider community.[4]

A.2.4. Authorization to Pursue Self-Interest

A market economy defines the powers of private ownership and private transfer in such a way that market actors are authorized to exercise these powers on the basis of considerations stemming from their own self-interest. Consider that, as a parent, I have a certain legal power to determine where my young children will be during the day. This parental power is private in the basic sense that I am not typically required to consult with my neighbors, political officials, or other citizens about when or how to exercise it. But an important feature of this power is that I am required, for the most part, to exercise it on the basis of considerations stemming from the best interest of my children rather than my own self-interest.

[4] People sometimes think of private property as a system of "primary rules" in Hart's sense. But Hart (1997) himself rightly recognizes that private property as we usually understand it consists of both primary *and* secondary rules. The powers of private property consist not only in a set of first-order obligations for people to return objects to their owners or to refrain from trespassing on other people's property, but also the power to change these first-order obligations by, say, giving people permission to walk across your lawn. In this way, private property itself allows a norm-system to adapt to changing social circumstances by allowing owners to adapt first-order obligations to changing preferences or environmental conditions.

What about the initial acquisition of resources? A market arrangement must define powers of private ownership and private transfer, but it need not define powers of private appropriation or initial acquisition (cf. Locke [1698] 1998; Nozick 1974). Many social forms that we properly recognize as markets today incorporate very significant historical departures from the private appropriation and acquisition. The markets that we see in Russia and China today grew out of a massive process of privatization in the early 1990s that saw the state changing the legal status of land, machinery, investment capital, and other assets from state-owned property to privately owned property. This suggests that private appropriation and acquisition is not essential to a market arrangement.

A market economy defines the powers of private ownership and transfer differently from the way that the law defines the power that parents have over the whereabouts of their children. Market actors are permitted to make decisions about the use of their property, access to their property, and the transfer of ownership based simply on considerations rooted in their own self-interest. For instance, I can rent my house to a certain individual on Airbnb simply because this person offers me adequate consideration. My ownership powers do not incorporate restrictions that prevent me from focusing exclusively on these sorts of considerations.

A.2.5. Mutual Disinterest (*quid pro quo*)

The rules of a market economy authorize people to exercise the powers of private ownership and transfer on the basis of considerations that stem from their own self-interest. But in addition, the rules *preclude* market actors from exercising these powers on the basis of considerations that stem exclusively from the interests of other agents. This is the requirement of "mutual disinterest," and it is essential to a market.

Consider a standard market interaction. Suppose that you go to a hotel to stay the night. The hotel has private ownership over its rooms, and you have a certain amount of money in your bank account. The hotel does not give you a room simply because it would be in your interest to have one: the hotel withholds access until you offer something that makes it worthwhile for the hotel to give you access. By the same token, you do not turn your money over to the hotel simply because it would be in the hotel's interest to have the money: you withhold your money until the hotel offers something that makes it worthwhile for you to turn over the relevant sum.

If we think about the interaction from the perspective of the parties involved, we see that there is a shared set of rules for the interaction that everyone recognizes. You understand and accept that the hotel is not going to give you a room unless you offer something of adequate value in return. And the hotel understands and accepts that you are not going to turn your money over unless it offers something of adequate value in return. If either you or the hotel starts citing its own needs in the discussion or starts citing religious authority, the other party could point out that this is a market interaction, so these other considerations are not relevant. The rules of market interaction require the parties to act in a mutually disinterested fashion and to act with the expectation of disinterest from the other party.

Many readers might be tempted by a different interpretation of the rules of market interaction. According to the alternative, the rules incorporate a *permission*, but not a requirement, for market actors to reason in a mutually disinterested way. The problem with the permission view, however, is that it does not conceptually restrict market interaction in the right way. Imagine, for example, that you get to the hotel in the previous example and the hotel just gives you a room, purely on the grounds that you need one. If the rules of market interaction incorporate only a permission to act in a mutually disinterested way, then the hotel's interaction with you would count as a market interaction. Similarly, suppose you get to the hotel and just donate your money to the enterprise on the grounds that this would help the hotel. On the permission view, this too would count as a market interaction. But neither of these interactions is a market interaction, most obviously because neither of them is an "exchange" in the strict sense.

Acts of charity and friendship have their place in social life, but these acts are precluded in market interaction. Market interaction requires people to interact *in an unusual way*, each person reasoning about how to exercise her market powers exclusively on the basis of her own egoistic interests. This is one of the things that most clearly distinguishes market interaction from other normative practices, such as the family, friendship, and political community. Markets are fundamentally a domain of bargaining, exchange, and competition.

The point is fundamental and has to do with the deeper justifying rationale that unifies and makes sense of the various elements of a market economy. According to the standard economic view, the justifying rationale for a market economy is that under ideal conditions, rationally self-interested actors, operating within a legal framework of completely defined property rights, will uncover all possible exchanges that are Pareto improvements and make these exchanges. This will bring about and maintain a social state that is Pareto optimal. The fact that market actors reason in a mutually disinterested way is important because (among other things) it ensures that each actor pursues the satisfaction of the interests in society that she knows best—i.e., her own. If market actors were not reasoning in a mutually disinterested way, but were making charitable contributions to each other, then many of the transfers they make would not be Pareto improvements, since people do not have any special expertise when it comes to other people's preferences (see Sen 1984b). As such, the standard economic rationale for a market economy applies to an institution that is based on bargaining and exchange, not charity or friendship. To the extent that the various requirements of a market economy are understood as justified insofar as they serve the aims of economic efficiency, we should think of a market economy as an institution that incorporates a requirement of mutual disinterest, not just a permission.

In order to appreciate the point, it helps to see how the requirement of mutual disinterest is explicit in more sophisticated market arrangements. Consider that both competition law in Europe and antitrust law in the United States make it *illegal* in many cases for market actors to act in something other than a mutually disinterested way. For example, suppose two computer chip manufacturers, X and Y, agree to partition the global market, X focusing on North America and Y on Europe. Here the two manufacturers are not acting in a mutually disinterested fashion with respect to each potential exchange with consumers. X agrees to act in a way that serves Y's interests with respect to European consumers, and Y agrees to act in a way that serves X's interests with respect to North American consumers. They agree to this partitioning of the market in order to extract greater benefits from consumers. This form of collusion is illegal, both in North America and in Europe, in part because it limits the operation of the processes of bargaining, exchange, and competition that are at the heart of the economic rationale for a market economy.

The fact that the institutional model incorporates a requirement on market actors to reason in a mutually disinterested way has important implications for how we think about a market economy. Once we see that mutual disinterest is a requirement, it becomes clear that "pure" market interaction is not nearly as common as we might think. Even on the floor of the New York Stock Exchange, people are involved in more than just market interaction. In a fascinating sociological study, Mitchel Abolafia (1997) finds that traders are constantly according a certain degree of consideration to the interests of their fellow traders in response to the past consideration that their fellow traders have shown to them. When traders show consideration for one another in these ways, they are not acting in a mutually disinterested fashion; they are acting in a way that answers to the rules of professional collegiality.

On my view, traders on the floor of the NYSE are properly understood to be subject to the requirements of *two overlapping institutions* or *practices*: professional collegiality, on the one hand, and market interaction on the other. The rules of professional collegiality require traders to act with a certain degree of mutual concern. The rules of market interaction require traders to act with mutual disinterest. I take it that traders have reasons to comply with the requirements of both of these institutions. They have to interpret and balance the requirements of each one, and they may sometimes face moral dilemmas because the institutions make incompatible demands. What we see on the floor of the NYSE generalizes, so actors in a complex social world often find themselves subject to the conflicting demands of the market economy and other distinct social institutions.

A.2.6. Authorization to Act Foreseeably against the Interests of Others

Going beyond simple mutual disinterest, a market economy authorizes market actors to exercise their powers of private ownership and transfer based on considerations of self-interest, and in addition, it authorizes them to do so even when they see clearly that doing so would *damage* the interests of others.

Suppose that hotel A is offering you access to one of its rooms for \$X. Hotel B sees this and offers you access to one of its rooms for \$(X–1). Hotel B exercises its powers of ownership and transfer in a way that will foreseeably damage hotel A's interests by taking a customer away from A. It is possible to imagine an arrangement that requires actors to exercise their powers in a mutually disinterested fashion but prohibits them from exercising their powers in ways that would foreseeably damage the interests of other parties. In the standard case, however, markets are *competitive* enterprises. For a market to be competitive, it must empower market actors to act in ways that would foreseeably damage one another's interests; this is essential to both competitive bidding among actors and competitive bargaining and negotiation.[5]

Competition law formalizes the competitive aspect of market interaction. In some cases, the rules of competition law simply prevent market actors from taking steps that would constrain the freedom of other actors to act in ways that damage the interests of third parties. For example, legal restrictions on "noncompete" clauses in contracts are a way of ensuring that workers and firms in the market will remain free to seek exchanges that might harm the interests of other market actors. But sometimes the rules of competition law are not focused on actors preventing *other* actors from competing; they are focused on ensuring that actors *themselves* actively compete with other actors. For instance, in agreements that divide a market, the actors involved fail to take advantage of certain opportunities in order to respect some reciprocal agreement. On balance, however, competition law tends to focus on "restraints" on competition rather than directly requiring individuals and firms to pursue their own interests, even at the expense of others.

[5] Let me just note here that the economic rationale for competitive bargaining and negotiation in a market economy is far less obvious than for competitive bidding.

Since the philosophical image of a market economy typically does not incorporate the requirements of competition law and antitrust, it might help to see how expansive these laws are. Here is the main statute of European competition law pertaining to anticompetitive practices:

> The following shall be seen as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object *or effect* the prevention, restriction or distortion of competition within the internal market. (Treaty on the Functioning of the European Union, Article 101, my emphasis)

Here are the two most important provisions of US antitrust law:

> Section 1: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States or with foreign nations, is declared to be illegal." (15 U.S. Code §1)
>
> Section 2: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States or with foreign nations, shall be deemed *guilty of a felony*." (15 U.S. Code §2, my emphasis)

Two features of the statutes stand out. First, under European competition law, agreements, decisions, and concerted practices may be illegal simply if the *effect* of these is to prevent, restrict, or distort competition—it is not necessary that they are also intended to have this effect. In focusing on the effect of a practice on the scope of competition, European competition law imposes a more powerful set of legal restrictions on the "liberty" of actors in the market to do what they want with their property. The rules involved here are radically different from a scheme of libertarian property rights that would allow for any agreement, decision, or concerted scheme, regardless of how it might affect competition, so long as the individuals were not coercing others to get what they want.

Second, under US antitrust law, efforts to monopolize trade or commerce among states or with foreign entities are not just illegal—they can be criminal. This feature of US antitrust law makes it especially clear that the requirements on market actors to behave in a competitive fashion are not tangential or accidental. They are often treated with the utmost seriousness—often on a par with more ordinary forms of theft.

Taken together, these six features define a "basic bargaining system." If you think of kids trading baseball cards at recess, you have a good illustration of this kind of arrangement. Each person is recognized as an actor in the system. She has cards that she owns and the power to trade for cards that she does not own. Actors are each empowered to use their various powers to advance their own interests, and insofar as the system is a bargaining arrangement, there is a general prohibition on people simply giving their cards away. The system is competitive because anyone can offer better terms to a potential trading partner in order to lure her away from other potential trading partners. This is the most barebones idea of a market that covers everything from stock exchanges to fishmarkets and Turkish bazaars.

A.2.7. Production for Sale

A basic bargaining system could be anything from trading livestock at a county fair to trading vorpal weapons in World of Warcraft. But a market economy is different from most other types of bargaining systems because a market economy is supposed to play a certain role in social life.

Most societies adopt a market economy to shape how members make things and consume things, expecting that the institution will have a salutary effect on patterns of production activity and consumption activity. For instance, many theorists believe that markets are attractive because they have a beneficial impact on the social division of labor: markets will generate a pattern of specialization that increases economic output, potentially benefiting everyone in society (see Smith [1776] 2000; Hegel [1821] 1991; Marx [1867] 1967). But in order for a market to perform this social coordination function, the institution must have certain features that enable it to reshape social life. The requirements that I am calling *production for sale* and *mediated consumption* together articulate the features that are necessary for the market to perform this function, and these features distinguish a market economy from other types of bargaining systems (see Lindblom 2001).

To understand production for sale, note that a modern society is divided into *households*. Each household has among its members individuals who produce things; e.g., my household consists of four people, and we all engage in various production activities (e.g., making meals).

When I look at my own household and the production activities of its members, a very surprising fact is that most of these production activities are not oriented toward producing goods that will directly satisfy the needs of members of the household. For instance, I spend much of my life grading papers, but my children are too young to write college papers, so this activity does not produce anything that is directly useful to them. My productive efforts in grading papers are oriented toward producing goods that satisfy the needs of people in other households in my community—i.e., households with college-age members. Much of my wife's activities are oriented toward other households as well.

The connection between my labor and the needs of people in other households arises because I do not make decisions about what to produce based simply on the value that the goods I produce would have if they were directly consumed by members of my own household. If I were to make decisions about how to deploy my labor power based solely on these considerations, I would probably spend my days doing completely different activities—e.g., farming, sewing, and chopping firewood. I am led into grading papers and other productive activities because I make production decisions based substantially on the value that the goods I produce would have in *exchange* with other households. In other words, I make decisions based in part on the "exchange value" of the goods that I produce (i.e., the value that a good has in securing other goods through exchange that would directly satisfy the needs of members of my household).

Now imagine the following possibility. Imagine that a community consists of a large number of households, where each household's members make production decisions based solely on the value that the goods they produce would have in directly satisfying the needs of members of their household. In a community of this kind, each household would be reasoning in an "autarkic" fashion, treating production decisions as if the household were isolated from other households in the community.

Autarkic reasoning has important implications for market coordination. If members of each household reason in an autarkic fashion, then each household would organize its production activities in order to directly satisfy the needs of its members. Households might still engage in trade, but they would simply trade whatever goods were left over from their production activities once the needs of their members were satisfied. Bargaining and exchange would redistribute the "accidental surplus" left over from household production. But bargaining and exchange would not penetrate the household itself in order to reshape production activity within each of these units. Given that society-wide patterns of production are simply the aggregate patterns formed by the activities of each household in the community, the autarkic reasoning of households would prevent market interaction from reshaping society-wide patterns of production. Autarkic reasoning would prevent the market from restructuring my activity to serve the interests of people in other households and from restructuring the activity of people in other households to serve my interests. It would prevent the market from drawing everyone into an advanced division of labor that could serve everyone's interests.

On my view, the rules of a market economy, properly understood, preclude autarkic reasoning. Market actors are not authorized to make decisions about production based *exclusively* on considerations stemming from the value that these goods would have in directly satisfying the needs of members of their own household. In the full political sense, a market arrangement requires market actors to make production decisions from a point of view that incorporates the exchange value of the goods they produce (i.e., "production for sale"). Of course, market actors are not required to consider only the exchange value of these goods—I might decide to give up my job and work directly to satisfy my family's needs. But production for sale requires that any production decisions must be undertaken from a point of view that considers both the use value and the exchange value of the output.

A.2.8. Mediated Consumption

Mediated consumption is the flip side of production for sale. In my own household, I sometimes go to my fridge to get something to eat. When I look in my fridge, most of the things I find there were produced by people in other households (or by firms using resources made available to them by other households). Farmers in California grew the green beans in my fridge, Yoplait produced the yogurt, etc. The things that I find in my fridge reflect a certain pattern of reasoning. Members of my household do not make *consumption decisions* based only on the production possibilities that are available given the labor and resources that are directly under the household's control. We do not reason in an autarkic fashion with respect to consumption, any more than we do with respect to production. We make consumption decisions based on a form of reasoning that takes into account the consumption possibilities that are open to us in virtue of exchange with other households.

On my view, the rules of a market economy preclude autarkic reasoning with respect to consumption. Market actors are not authorized to make decisions about what to consume based *exclusively* on what the household could produce on its own. They must make consumption decisions from a point of view that takes into account not only the consumption possibilities available through direct production but also those available through exchange with other households.

The exclusion of autarkic reasoning is important again because it is essential for the market to function as a social coordination mechanism. If households in our society reasoned in an autarkic fashion with respect to consumption, market interaction would not be able to reshape society-wide patterns of consumption. Each household would make consumption decisions based solely on what its members could produce directly, and exchange would serve only to redistribute the accidental surplus left over when these goods were consumed. Bargaining and exchange would not penetrate each household to reshape its consumption patterns in light of the productive capacities of other households. By extension, bargaining and exchange would not reshape society-wide patterns of consumption, which are simply the aggregate patterns formed by the consumption activities of each constituent household. So a market economy rules out household consumption decisions based purely on the productive capacity of each household, taken in isolation from the others. Properly understood, the rules of a market economy require people to make consumption decisions based in part on the consumption possibilities available to individuals through exchange with other households.

A.3. An Advanced Market Economy

An Advanced Market Economy

1. Independent actors
2. Private ownership
3. Private transfer
4. Authorization to pursue self-interest
5. Mutual disinterest (*quid pro quo*)
6. Authorization to act against the interests of others
7. Production for sale
8. Mediated consumption
9. Organizing principles based on "economic efficiency"
10. A bureaucratic apparatus whose institutional role is to monitor market interaction, exercise institutional powers, and develop rules in light of the public justifying aim of the enterprise—i.e., "economic efficiency"

A.4. Two Final Notes

The institutional model sets out the central elements of a market economy, understood as a system of rules that members of a community could adopt as the content of a shared understanding about how they are supposed to think and act in various circumstances.

Some readers will note that the institutional model does not mention an array of requirements that are often mentioned in connection with markets, such as rational actors, full information, and the absence of market power. The model does not mention these elements because they are not essential to a market economy, understood as a shared scheme of rules for how people should think and act. Think of it this way. There are certain elements that are constitutive of baseball, understood as a particular rule-governed enterprise—runs, strikes, bases, batters, etc. At the same time, we could describe background conditions—e.g., a bright sunny day—such that playing a game of baseball is more likely to be fun and exciting when we play in these conditions. But the favorable conditions for a game of baseball are not the same thing as the constitutive rule structure that makes up the game itself.

In much the same way, the elements that make up the institutional model set out the elements that are constitutive of a market economy, understood as a particular kind of rule-governed enterprise. Alongside these institutional elements, we could also describe various background conditions such that interacting according to the rules of a market economy is more likely to generate the goods that we want from this interaction under these conditions. Perfectly rational actors, full information, and the absence of market power are best understood as favorable background conditions. When the members of a community adhere to the rules of a market economy, the interaction is more likely to generate and maintain an economically efficient pattern of production activity and consumption activity when it occurs in the context of these background conditions. But the background conditions themselves are not constitutive of a market economy, understood as a particular type of rule-governed interaction.

Let me offer a final analogy to sum up the institutional model. When you go to a baseball stadium, there are lots of things happening at the same time: players are playing baseball; parents are feeding their children; friends are exchanging stories; people are buying hotdogs; bosses are telling their employees what to do; etc. The baseball game is one particular rule-governed interaction that takes place in the stadium. If you are one of the players on the field, you might actually find yourself subject to several different schemes of institutional rules at the same time. Besides the rules of baseball, you might be subject to the rules of professional collegiality, the rules of conversational truth-telling, etc. These rules may sometimes conflict: when it comes to stealing signs from the catcher, conversational truth-telling may require one thing, but the rules of baseball may require another.

On the institutional model, the civil sphere in a liberal democracy is like a baseball stadium: there are lots of things happening at the same time. Among the different institutional enterprises that we find are families and households, friendships, scientific inquiry, organized religion, and professional services. The market economy is one of these institutional enterprises. Among the distinctive elements of this institutional enterprise is the requirement that market actors exercise their market powers in a mutually disinterested way. This requirement may come into conflict with the requirements of other important social institutions, such as professional collegiality or familial obligations. Nonetheless, mutual disinterest is constitutive of this particular institutional arrangement, at least insofar as it has a certain underlying economic rationale.

I have not said anything in this appendix about several related issues. For example, it is an open question how important the reasons for conforming to the rules of market interaction are when these rules come into conflict with other social rules (e.g., collegiality). When these reasons are not that pressing, it may be up to us whether to interact according to market norms or to interact according to the norms of, say, collegiality or friendship. It is also an open question what the proper scope is for market interaction. If Ronald Coase (1988b) is right, for example, then the economic rationale *itself* would build into the rules of a market economy certain limits that allow scope for other rules—i.e., the authority structure within a firm—to coordinate various forms of economic activity. But with respect to all of these issues, I take it that the central question is about the scope and importance of the market economy, an institution whose rules incorporate mutual disinterest as one of its central features.

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