PUTTING THE 'AMERICAN BUSINESS MODEL' IN ITS PLACE[1]

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All prosperous societies in the world today are, in some loose sense, market economies. Most objective criteria of success – health and educational achievement, respect for democracy and human rights, water and air quality – point to a similar conclusion. The countries at the top of the list are predominantly market economies. The induction of one to two billion more people into the market economy since the 1980s has raised more people out of poverty more quickly than in any previous period of human history. The market economy is the only game in town.

But there are many different kinds of market economy. The hubris generated by America's victory in the Cold War led to the wide acceptance of a mistaken view of how market economies function. That mistaken view, which (in *The Truth about Markets*, 2003) I have called 'the American business model,' emphasises that greed is the dominant human motivation, at least in economic matters. It believes that financial markets are the most effective regulator of economic activity. It also contends that the economic role of the state should be limited to the provision of a modest social safety net, the protection of private property, and the enforcement of contract.
This account of the market economy is at once repulsive and false. It was never a good description even of how the American economy functions. Property rights are not fixed by nature, but are social constructs. There are many different ways of defining the rules and conventions which regulate the relations between businesses, individuals and the state, and economic performance depends on the quality of these institutions.

Most of the products of a modern economy are complex, and trade in them is only possible because of trust relationships and the concern of suppliers for their reputation, buttressed by state regulation. Efficient production requires far more cooperation between individuals than the American business model allows. Despite the emphasis placed on the growth of the financial sector as a mechanism for risk management, the major risks of ordinary life – illness, unemployment, the breakdown of relationships – are dealt with by social institutions rather than market ones and are financed by state benefits. These risks are managed through the efforts of friends, family, and people who care.

Knowledge is a key product of a modern economy, but it cannot be produced in competitive markets with many impersonal buyers and sellers. Materialistic motivations have historically played only a minor role in the generation of new knowledge and this is not likely to change in future. The key to understanding why market economies have outperformed planned societies is not recognition of the ubiquity of greed, but understanding of the power of disciplined pluralism. The primary strength of the market economies – and certainly the strength of their economic performance – results from the way in which the market provides freedom to experiment and opportunity to imitate successful innovation, yet is ruthless in cutting off successful experiment. Planned societies, in contrast, have been typically slow to innovate and, when they have done, have been quietly slow to acknowledge when innovation has failed – as most innovations do.

The common theme to each of these observations is that markets operate in a social context. The social context is not an add-on, something separate from, but more fulfilling than, our economic

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lives: the social context is central to how our economic lives function. The variety of market economies reflects the variety of historical and cultural environments in which these different market economies have developed.

Conventional economic theory of the kind which is often used to give intellectual underpinning to the American business model is not 'wrong', just limited in application. The attempt to build a universal theory with ideological underpinnings and implications – an attempt which has dominated both economic analysis and economic policy for 20 years – has produced major errors in both analysis and policy. Our objective should be, not to replace markets, but to achieve a better understanding of how markets work, and their strengths and weaknesses.