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Yining Li

Beyond Market and Government

Influence of Ethical Factors on Economy



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Preface to the Revised Edition

This book explores how moral factors exert influence on the economy.

Not long ago, some students asked me, “Of your published writings, which three books do you believe best reflect your academic standpoint?” I recommended the following: *Unbalanced Chinese Economy* (Economic Daily Press, 1990; Guangdong Economic Press, 1998; Encyclopedia of China Press, 2009, which was reviewed as one of the “Top Ten Economic Works Influencing the Economic Development of New China”); *Beyond Market and Government* (Economic Science Press, 1999, nominated for the Fifth National Book Award 2003); and *Origin of Capitalism* (The Commercial Press, 2003, nominated for the National Publication Award 2007 and Prize of Honor winner in the China Publishing Group Book Award 2007). The second of these, first published in 1999, had the subtitle “Influence of Moral Factors on Economy.” This revised edition published in 2009 contains modifications and extra material to reflect the changes that occurred during the 10-year interval.

Four reasons account for the choice of the title—*Beyond Market and Government*. Firstly, as the book says, in the long period before the emergence and establishment of market and government, custom and morality were the only modes of regulation. This is not only true of remote antiquity; even in modern times, there have been isolated tribes, remote mountain villages, small islands, or migrant communities cultivating virgin land, where the only things working to regulate social and economic activities are custom and morality—not market or government. Therefore, we are justified in calling custom and morality a kind of regulation beyond market and government.

Secondly, in places where regulation by market or government does work, there are still some gaps that the two modes of regulation cannot reach owing to the limitations of their influence. Each does compensate for the other’s limitations, but only up to a point. For example, human beings as “social men” do not necessarily think or act only for economic benefit, nor will they always be passively subject to regulation by the government. The gap can only be filled by custom and morality. In this sense, regulation by custom and morality can be viewed as a regulatory mode beyond market and government.

Thirdly, social life includes a wide range of activities, one part of which is trading activity and another is non-trading activity. In the former, the market plays the role of regulator at the basic level and the government at a higher level. But the same cannot be said of non-trading activity, which is not restricted by market rules and mechanisms nor is subject to government intervention. The government is only responsible for defining its scope and ensuring that such activity does not overstep the boundary. Thus, non-trading activity has to be regulated by factors beyond market and government, namely, moral force.

Fourthly, once markets and governments do emerge, a variety of causes can give rise to market failure or government paralysis, rendering regulation by market or government ineffective or extremely limited. But even in such circumstances, custom and morality still exist and continue working as normal. This is another reason that custom and morality can be regarded as a mode of regulation beyond market and government.

For the above reasons, this book is titled *Beyond Market and Government*. It must be explained that regulation by custom and morality lies between regulation by market and regulation by government. Regulation by market is called the “invisible hand” and regulation by government the “visible hand.” Regulation by custom and morality is closer to the “visible hand” when its power to restrict is relatively strong and closer to the “invisible hand” when it is weaker.

But when is such power stronger or weaker? There are two main deciding factors. One factor is whether or not regulation by custom and morality has become a convention or a rule universally accepted by all members of the group. If so, its restricting power will be stronger; if not, it will be weaker. For example, a village rule is an agreement among all villagers, and they are obliged to follow it. In this situation, the restricting power of regulation by custom and morality embodied in the village rule is stronger. The second factor is the degree to which each member identifies with the group. If the degree is high, the restricting power is stronger; if not, it will be weaker. For example, if the villagers have a high degree of self-identification with their group, they will be more self-disciplined in following the village rules. That is to say, the rules will have more restricting power on the villagers.

Of course, in some situations, the restricting power of regulation by custom and morality is relatively weak, but this does not imply that it has no effect at all. Moreover, stronger does not always mean better where such power is concerned, since regulation by custom and morality takes many different forms. The above-mentioned village rules generally have stronger restricting power, whereas some regulation by custom and morality formed through self-discipline, despite involving no restricting power, can often play a role and influence individual behaviors.

In terms of social development trends, we note a continual increase in non-trading activities, in which regulation by custom and morality plays a major part. In the past when productivity was very low, trading activities barely existed, whereas non-trading activities covered almost all social and economic life. Later, with the increase in productivity, the traded sector gradually increased and expanded and the non-traded sector shrank correspondingly. When productivity increases to a higher

level, the share of the non-traded sector in socioeconomic life would gradually rise again. In other words, once the economy is highly developed, with income per capita increasing greatly, people's values and attitudes will change accordingly, as regards benefits, occupation, lifestyle and life itself, family and children, interpersonal relations, material wealth, spiritual enjoyment, etc. When national revenue and disposable personal income rise to a certain level, non-trading activities will increase and relations within the non-traded sector will develop at different levels. This is an inevitable trend of social and economic development. Consequently, as the major mode of regulation in the non-traded sector, regulation by custom and morality will play an ever more important role in social and economic life. In the past, regulation by morality has been an issue of interest to and exploration by specialists in philosophy, economics, and sociology, but I hope in the future more non-professionals will join us and think earnestly how regulation by morality plays a role beyond market and government.

This book devotes seven chapters to the role of moral factors on the economy. At present, discussion on this topic in academic circles is far from enough, as is our awareness of its importance in social and economic life (including the traded and non-traded sectors). That said, I believe this situation will change in the future. More people will join us in this study, and the role of regulation by custom and morality will be fully deployed. In this sense, my effort in writing this book will be worthwhile.

Beijing, China
October 2009

Yining Li

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Chapter 1

The Issue of Regulation by Custom and Morality

1.1 Historical Review

1.1.1 The Meaning of Regulation by Custom and Morality

To discuss the meaning of regulation by custom and morality and its past and present roles, one must start with the question of resource allocation.

People often ask what it is that economics studies and why we should study economics. Different schools may supply different answers, but none can get away from this thought: Economics is about allocation of resources, and the study of economics is the study of how to use limited resources in the most rational and efficient ways so as to increase the overall wealth of the society and make it increasingly affluent. Some scholars would go further: The study of economics is in order to use resources rationally and allocate them efficiently so as to increase the wealth of the society and make income or wealth distribution fairer and fairer. In short, economics is a science of resource allocation and its mechanisms.

In the discipline of economics, two standpoints on resource allocation have formed. The first holds: Resources can be allocated rationally and efficiently by means of market mechanism, and resource allocation theory is no more than a theory of spontaneous regulation by market on economy. The second considers: Market mechanism has many limitations in resource allocation such as low utilization rate, irrational allocation, unbalanced income distribution, etc.; therefore, market mechanism should be replaced or at least rectified through regulation by government (or regulation by plan). Between these two attitudes, many other different viewpoints exist such as: Equal importance should be attached to the two means of regulation; either regulation by market should play the major role and regulation by government the auxiliary role or vice versa. In general, current study on resource allocation mechanism shows the existence of the two means is universally accepted and the only disagreement is on their relative weighting in resource allocation.

Regulation by market and regulation by government are two distinct modes of resource allocation. But in fact, ever since the appearance of markets and governments, neither of the two modes has been the only one at work in social and economic life. In a market economy, a more realistic view is: Market plays a basic role in resource allocation and regulation by government a high-level role. Both modes exert influence on social and economic activities. Wherever there are trading activities, the market mechanism is at work. Wherever there is government, there is government supervision or guidance, be it direct or indirect, on trading activities so that they remain in line with government aims and within the boundaries it defines. In this sense, regulation by market as a basic mode can be called “primary regulation” and government regulation, as a high-level mode, “secondary regulation.”

Now, we want to ask: Are there only the two means of regulation in social and economic life? Is there another, a third type of regulation? And if so, what is it?

As previously stated, the terms “regulation by market” and “regulation by government” both indicate the mechanism by which resources are allocated, namely, the resource allocation rules by which social and economic life operates. Without a market, there could be no regulation by market and without government, no regulation by government. However, human beings have been on the earth for hundreds of thousands of years, whereas market appeared only several millennia ago and government even later, so how did human society and its economy run, and how were resources allocated in the long period before regulation by market and by government were established? Is it possible that another means of regulation was there to allocate resources? If not, how could human society have survived till today?

Barter, a type of transaction, first appeared among tribes and can be regarded as an embryonic form of spontaneous regulation by market. At that time, predating both states and governments, there were no concepts of government management or regulation of resource allocation. Then, we may enquire: In the long period before the appearance of barter or within tribes after intertribal dealing emerged, given that there was no market force or government force, what was it that controlled resource allocation between people or between tribes? It could only be force of custom or morality. Factors of custom and morality constitute a cultural tradition that is universally accepted and followed by people and through which they handle and adjust their interpersonal relations. Under the influence of this cultural tradition, people’s behavior becomes more orderly and conforming. Even in remote antiquity this was the case.

In light of this, regulation that relies on the force of custom or morality—a regulation beyond market and government—can be called “the third regulation.” Since production factors are provided and employed according to custom and production outputs are distributed on this basis too, it can undoubtedly be called “regulation by custom.” Custom comes from tradition and group identification, the foundation of which is moral belief and principle. Since custom is supported by morality, regulation by custom is inseparable from regulation by morality. Hence, they can be compounded under the term “regulation by custom and morality.”

In his work *A Theory of Economic History*, the British economist John Hicks used the term “customary economy” and considered it the earliest model of non-market economy. He pointed out that “the economy of a neolithic or early mediaeval village, as well as of tribal communities, was not organized by its rulers (if such

existed); it was based upon a corpus of tradition. By that tradition individual function was prescribed, and continued to be prescribed.”¹

According to Hicks, in “customary economy” “people are not much disturbed in their ancient ways by external pressures. Their economy can function, with every member performing his allotted task, including the decision-making which is left to him within his allotted circle; overriding decisions from the “centre” will scarcely ever have to be made.”² Such “customary economy” is self-adjusting for maintaining a balanced state. As Hicks wrote, “once the system has attained an equilibrium, it can continue for long ages without the need for reorganization—without the need for decisions of an organizational character. The ordinary emergencies, such as harvest failures or attacks by the “usual” enemies would not require new decisions; ways of dealing with them could be incorporated within the tradition rules. So long as the equilibrium persisted, there might even be no need for an organ by which ultimate authority could be exercised.”³ Without doubt, the “customary economy” described by Hicks was an economy regulated by force of custom and morality only.

But does it follow that with the emergence of markets and governments and regulation by them, regulation by custom and morality disappeared? Far from it: The diminished importance and influence of regulation by custom and morality does not imply its total disappearance. Indeed, in areas where regulation by market and government cannot reach, it still plays a major role. For example, there are places outside the reach of government—remote mountain villages, small islands, wilderness lands—but there are people living, working, and multiplying there. It is regulation by custom and morality that enables them to continue living and producing there.

We come to a preliminary conclusion: Before the appearance of regulation by market and government and in places where market and government factors cannot reach, regulation by custom and morality is the only form of regulation that works.

1.1.2 Coexistence of the Three Modes of Regulation

Since the appearance of markets and governments, there have been occasions when regulation by custom and morality comes into play as well as the other two modes, thereby creating a situation of three types of regulation coexisting and cofunctioning.

A typical example is the social and economic life of medieval cities in Western Europe.

In Western Europe, since the tenth century or so, some old cities in decline experienced a revival. New houses were built on the ruins of the old city, forming new neighborhoods, or industrial and commercial districts emerged along the old city boundaries and gradually became an integral part of the city. More importantly, a group of new cities appeared. Different from the ancient cities both in political and economic terms, these revived or new medieval cities came into being and developed

¹ John Hicks [1, p. 15].

² Ibid.: 14.

³ Ibid.: 14–15.

as something different from serfdom and as places of refuge and resettlement for escaped serfs. Many of those serfs became craftsmen, and their organizations were called guilds. Members of a guild, or guild-masters, were owners of manual workshops. They sold their products and bought raw materials in the market, so their behaviors were regulated by the market. The administration of the city, or the municipal government, formulated a series of rules for the market and the production and operation of the workshops in terms of product price, operating hours, borrowing and lending rates, etc. This was regulation by government in action. The guilds also had their own rules. For example, they set a ceiling on the number of journeymen and apprentices in each workshop. In some cities, guilds even made it a rule that each guild-master could have only one workshop.

In some cities, guilds also set restrictions on production equipment in each workshop such as the number of ovens in bakeries, the number of looms in textile workshops, and so on. Some guilds forbade opening underground workshops or covertly producing on equipment hidden in other people's houses. All facilities should be for self-use only, and hiring was not allowed. Some guilds set limits on family members involved in production. For example, only sons, brothers, and nephews of an owner were allowed to participate in production, and no further relatives could be included. To do otherwise was considered covert hiring and an obvious violation of the rules. All rules and restrictions were set by the guilds to safeguard the stability of their trade at a period when the cities of medieval Western Europe were in their initial stage of development. By this means, no manual workshop would expand to a size large enough to threaten other workshops. The rules set by the guilds were based on traditions accepted by all members, therefore they belong neither to regulation by market nor to regulation by government but to regulation based on the power of custom and morality. In those medieval cities, regulation by custom and morality coexisted with regulation by market and government, all of them playing a role.

Another example of such coexistence is found in the activities of some farming communities in modern Western countries. With the maturity of the market, farmers likewise subjected their producing activities to regulation by market such as what crops to plant, what livestock to raise, at what price to sell their products, etc. Any fluctuation in market price would influence the production and operation of farming households. Price changes and surplus and shortage of farm products are matters of concern to government; when necessary, it takes different measures to regulate the market so as to ensure a certain amount of income for each farming household and that the prices of agricultural products are kept at a certain level. Besides regulation by market and government, farmers also set up their own organizations with the aim of protecting their own interests, minimizing losses caused by market fluctuation or resisting government measures injurious to their development, etc. Once joined in such organizations, farmers should obey relevant rules, and the organizations should protect the rights of all members while restricting their behaviors. This can be classified as regulation by custom and morality. Therefore, farmers' social and economic activities in modern Western countries exist in the context of the three types of regulation.

On those occasions when the three coexist and function together, the relative strength of the role played by regulation by custom and morality is not necessarily determined by that of regulation by market or regulation by government. Actually, their relationship is too complicated to be summed up with the formula “A is stronger and B weaker or vice versa.” Of course, we do often see occasions when regulation by market and government being weak, regulation by custom and morality becomes stronger to compensate. Here are two illustrative examples.

One: In history, in areas newly opened up by immigrant communities, since regulation by market or government did not then function, resource allocation had to depend on regulation by custom and morality. In the early period of the Protestant migrants opening up North America, it was regulation by custom and morality that filled the gap caused by the absence of regulation by market and government. The former element was strong and the latter weak.

China’s history affords many similar examples. In the period of the Southern and Northern Dynasties, in the last years of the Tang, and in the Five Dynasties period, waves of people living in the Central Plains area migrated south and congregated in areas such as Fujian and Guangdong, where families settled down, establishing new villages, preserving their old cultural traditions while starting up new undertakings. In such places, no adequate regulation by market or by government existed, so regulation by custom and morality dominated the social and economic life of the migrants. From this, we can see how great the vitality is of cultural tradition formed under the influence of custom and morality. Thanks to the power beyond market and government, namely, the power of custom and morality, those immigrants managed to overcome a multitude of difficulties in the turmoil of war, migrating with their families and establishing a new homeland in the remote South. The force of custom and morality was a force beyond market and government.

Two: After the appearance of markets and governments, there were many occasions of great unrest, such as invasion by alien peoples, peasant uprisings, feudal separatist rule, wars between warlords, etc. A folk adage goes, “take shelter in the towns at times of minor unrest and in the villages during major upheaval.” In the former case, country folks were likely to take refuge in towns since these were guarded by soldiers and people were safer there, a proof that regulation by government still worked in towns and that social and economic order was maintained. At times of major upheaval, townspeople were likely to flee to the countryside, to remote places or mountain areas in particular, since towns, usually being places of military and strategic importance and therefore fiercely contested, faced the risk of siege and running out of water and food. Even government forces could not maintain normal order, so people had to flee to the countryside, putting as much distance as possible between themselves and the towns. At such times of great upheaval, trade was suspended, and regulation by market could not function. With government paralyzed, regulation by government failed too. However, in remote villages or mountain areas far from the towns, there were still residents living and working. So how did such communities and economies run? How were resources allocated? All these depended on a regulating force beyond market or government; namely, the