

TOP-DOWN PLANNING, MARKET FAILURES AND SPONTANEOUS  
ORDERS

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## I. INTRODUCTION

“‘Civil society’ is the term given to the network of relationships men form for mutual and cooperative improvement of their lives through free association. And ‘market economy’ is the term that refers to the network of exchange relationships in a division of labor through which men achieve gains from trade to better their lives.”<sup>1</sup>

Civil society and market economy are complementary in that both thrive on high levels of trust. Moreover, mounting evidence suggests that we can explain the astonishing improvement in the material condition of humanity since, say, 1750, via a virtuous cycle whereby people demanded liberties, including economic freedoms, which helped to promote, both civil society and market exchange. The ensuing prosperity created the demand for more economic freedom, and so forth.

A smooth unfolding of the virtuous cycle is, of course, too good to be true. One writer explains the inevitable interruptions, notably in much of the 20<sup>th</sup> century. These too provide important lessons. Lindsey<sup>2</sup> argues that post-1750 liberalization was interrupted by the “Industrial Counterrevolution”. The shock of rapid social, economic and cultural change prompted a widespread search for top-down antidotes. These included socialism in Europe and progressivism in the U.S., which prompted economic missteps, including top-down economic planning and protectionism which, in turn, led to economic depressions, wars, and despotisms which brought on more missteps, and so forth.<sup>3</sup>

Are we now back on course? Recent research by Julian Simon, Bjorn Lomborg and many others identifies considerable data on behalf of the idea

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<sup>1</sup> Ebeling, Richard M. (2004, p. 3) “Democracy, Freedom and the Market” *The Freeman: Ideas on Liberty* 54:9.

<sup>2</sup> Lindsey, Brink (2002) *Against the Dead Hand: The Uncertain Struggle for Global Competition*. New York: John Wiley and Sons.

<sup>3</sup> Erich Weede, (2004) has written on “The Diffusion of Prosperity and Peace”. “... [F]irst, there is an indirect link running from free trade or economic openness to prosperity and democracy and ultimately to the democratic peace; second, trade and economic interdependence by themselves reduce the risk of military conflict” (p. 181). *The Independent Review*, 9:2.

that, *You Have to Admit It's Getting Better*<sup>4</sup>, the apt title of an anthology that reinforces the Simon-Lomborg message.

Meanwhile, many discussions in the planning field explicitly or implicitly invoke a model, the neo-classical model of economics, which is almost silent regarding the big story. This view identifies broad areas of “market failure” and implicitly or explicitly invokes top-down interventions that would, presumably, make things right.<sup>5 6</sup> The simplest approaches do not question the efficacy of the proposed fixes or the possibility of “government failures”. Urban traffic jams are not simply a “market failure”; they are a policy failure because the owners of heavily used privately owned roads would spontaneously implement peak-load pricing. The low-transaction cost toll collection and monitoring technologies are here and have been proven.

Many also view market-determined income and wealth distributions as invariably demanding various top-down interventions. The conventional discussion of market failures misses the really interesting dynamics: people have incentives to discover ways to lower transactions costs and/or extend property rights, thereby bringing new goods and services into the exchange economy – and out of the commons. And economic growth also happens to be a powerful anti-poverty policy.<sup>7</sup>

We hear the litany of “market failures” so often that many writers have been slow to consider the many modern challenges to the neo-classical view and have not bothered to re-consider the implications for planning. This paper will offer a brief summary of some of the limits of neo-classical economics and will suggest that various interesting lessons from the study of economic development suggest a circumscribed role for top-down planning.<sup>8</sup>

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<sup>4</sup> Anderson (2004) *You Have to Admit It's Getting Better: From Economic Prosperity to Environmental Quality*. Stanford, CA; Hoover Institution Press.

<sup>5</sup> 1930s-era welfare economics dwelled on problems of externalities, public goods, monopolies, etc. Modern neo-classical economics emphasizes problems arising from asymmetric information and network effects. Both, the old and the new, market failure discussions have their critics. See, for example, Cowen and Crampton (2002) *Market Failure or Success: The New Debate*.

<sup>6</sup> The June 2004 issue of *The Review of Austrian Economics* (17: 2/3) is wholly devoted to “Urban Interventionism”.

<sup>7</sup> Dollar, David and Art Kraay (2001) *Growth Is Good for the Poor*. Washington, DC: The World Bank.

<sup>8</sup> A related argument was made in Wolf, Charles (Spring 1979) “A Theory of Non-market Failures” *The Public Interest*, No. 55.

The strong assumptions required for the traditional welfare economics theorems to hold have been dubbed “nirvana economics”.<sup>9</sup> The model represents an intellectual achievement but its continuing dominance may be inappropriate. “Austrian” economists, instead, emphasize a Smith-Mises-Hayek-North tradition that highlights the following:

- The world is dynamic. Equilibria (and their efficiency properties) once achieved are less interesting than the *processes* that reveal strong tendencies towards such equilibria. Imperfect humans with imperfect data, prompting occasional resource misallocations, is not a novel idea; what is auspicious is the finding that there are endogenous processes whereby these are mitigated. Market economies have a natural tendency to grow -- *including a tendency to develop institutions (continual adaptation) that alleviate expected market failures*.<sup>10</sup> The institutional context is *not* taken as a given.
- Entrepreneurial discovery is the driving force that prompts the system *towards* ever more attractive equilibria. This explains how societies better provision themselves over time, and especially how many have done so with remarkable success over the last 250 years.
- Dispersed (“local”) knowledge gives rise to mutually beneficial exchange; the division of knowledge is every bit as important as the division of labor.
- Discovery is inherently not subject to prediction. It involves successive approximations and feedback. It thrives in a setting of decentralized decision-making, competition and clear property rights.

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<sup>9</sup> Demsetz, Harold (1969) “Information and Efficiency: Another Viewpoint” *Journal of Law and Economics*, 12: 1, 1-22.

<sup>10</sup> Evolution as the basis of successful spontaneous orders was famously described by F.A. Hayek. Many others have recently explored related views, including Rubin, Paul H. (2002) *Darwinian Politics: The Evolutionary Origin of Freedom*, New Brunswick, NJ: Rutgers University Press; Seabright, Paul (2004) *The Company of Strangers: A Natural History of Economic Life*, Princeton: Princeton University Press; Ridley, Matt (2003) *Nature vs. Nurture: Genes Experience and What Makes Us Human*, New York: Harper-Collins; Dennett, Daniel C. (2003) *Freedom Evolves*, New York: Viking; Wilson, David Sloan (2002) *Darwin’s Cathedral: Evolution, Religion, and the Nature of Society*, Chicago: University of Chicago Press. The analysis also evokes the cases reported by Ostrom, Elinor (1990) *Governing the Commons: The Evolution of Institutions for Collective Action*. Cambridge, UK: Cambridge University Press.

Institutional differences, therefore, explain differences in the wealth of nations.<sup>11</sup> The ones that work best are selected spontaneous orders.

- Top-down economic planning is an impossibility because, absent markets that reveal (and continuously refresh) scarcity signals (e.g., prices), complex decentralized coordination is impossible. Were planners to magically divine an uncountable number of prices, they would be overwhelmed by the sheer magnitude of the data.
- The conduct and the record of regulators supports the public choice insight that they can be expected to operate for personal gain, moreso than the conventional public service view presumes.
- A powerful state role mobilizes interest groups that politicize most allocations. This view has inspired theories of rent-seeking and rent-extraction.
- Institutions evolve in ways that can be explained. And an institutional setting that maximizes economic freedom generates the most prosperity. Considerable empirical support for this link has been developed.<sup>12</sup> Some of it points to a virtuous cycle whereby increasing prosperity and an increasing demand for property rights reinforce each other.

Some have added that economic freedoms also promote political freedoms, strengthening the link between liberty and prosperity. Others cite the Environmental Kuznets Curve (EKC) and considerable empirical evidence that the virtuous cycle also benefits the natural environment.

## II. MARKET-CHALLENGING GOODS (AND SERVICES)

The implication is, then, that the enduring and widespread discussion of market failures resembles the building up and tearing down of a straw man. I argue that it is much more useful to identify the ways in which market-based institutions *evolve* (when we let them) to mitigate an array of problems by building up markets and civil society.

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<sup>11</sup> Many of the studies that make this empirical point are cited at [www.freetheworld.com](http://www.freetheworld.com).

<sup>12</sup> Ibid.

Various documented episodes that provide evidence for the assertion are summarized in *The Voluntary City* – hereafter *TVC*.<sup>13</sup> Examples that highlight the real-world supply of “market-challenging” goods help us to re-examine the simple and sweeping assertions of the neo-classical model.

Consider the evidence of the history of voluntarism in social services, including the remarkable history of fraternal orders and friendly societies in nineteenth century America and Great Britain. These spontaneous developments provided members with medical care, unemployment insurance, sickness insurance, and many other social services.<sup>14</sup>

Examples like this suggest we move beyond a restricted view of either markets or human nature. With respect to markets, they call attention to the vital, but too often neglected, role of the non-profit sector. Proponents of markets view the profit-maximizing firm as an ideal and the attenuation of profit incentives an unwelcome divergence. Proponents of government, while more supportive of non-profits, have tended to see the non-profit sector as weak, frail and marginal. Nevertheless, recent data show that 10 percent of the U.S. workforce is involved in non-profits’ activities (about two-thirds as paid staff and the rest volunteers), compared to less than 5 percent average for the surveyed countries.<sup>15</sup> These groups are auspicious in such important industries as health, education, and high culture. Yet, they were important in these industries long before receiving tax breaks or regulatory advantages.

Non-profits and the market *both* involve voluntary action. The voluntary and spontaneous nature of “open-source” programming is another case in point. We need not spend time wondering if it is “Beyond capitalism.”<sup>16</sup> By focusing on for-profit firms, proponents of markets have often overstated the case for markets narrowly conceived. Yet by ignoring the role of non-profits, opponents of markets have *understated* the case for markets *broadly* conceived. What neo-classical economics refers to as “market failure” is actually a limited set of problems associated with for-profit firms. *TVC*

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<sup>13</sup> Summaries of the various essays are from Beito, Gordon, Tabarrok (2003) *The Voluntary City*, Ann Arbor: University of Michigan Press, and an essay (Ch 9) by the same authors forthcoming in Eran Ben-Joseph and Terry S. Szold, *Regulating Place and the Shaping of Urban America*. New York: Routledge.

<sup>14</sup> Beito (Ch 8), Green (Ch 9), Tooley (Ch 10), *The Voluntary City*.

<sup>15</sup> Johns Hopkins Comparative Nonprofit Sector Project.

<sup>16</sup> “Open source: Beyond capitalism” *The Economist* (June 12-18, 2004), pp 16-17.

authors allude to “the market” broadly to include non-profit firms and other voluntary not-for-profit organizations. Thereby, the scope of market failure is diminished. Thus, rather than arguing for a larger role for markets, TVC authors argue for a larger role for *civil society*. To favor civil society is not necessarily to regard self-interest as the sole or even most important motivator of human action.

The market/government debate has often proceeded as if it were a debate between self-interest and selflessness. Yet we now know that our ancestors learned to forge connections and developed a social nature for the practical reason that such connections enhanced survival, just as did their capacity for self-interest. Humans are neither purely self-interested nor purely altruistic. It should come as no surprise that other-regardingness is not absent from markets -- just as public choice analysis suggests that self-interest is not absent from government. Indeed, economists are beginning to examine the nature of economic benefits that individuals gain by participating in various networks.<sup>17</sup>

The issue, therefore, is not human nature but rather how different institutions channel important aspects of human nature. Adam Smith argued that markets channel self-interest into socially beneficial directions. The public choice school of political economy argues that government institutions often channel self-interest in socially undesirable directions. But as of yet, *there is no well-developed theory of how other-regardingness is channeled by civil society or by government.*

TVC authors argue that the voluntary arrangements that had evolved in the past (and that in some cases are returning today) had much to offer. The welfare state did not so much create new institutions as crowd-out the civic associations that people had been spontaneously fashioned to provide “public goods,” “safety nets”, “law and order” – and land use planning. Only the latter is discussed here.<sup>18</sup> Were the spontaneously created institutions of the civil society better than the government institutions that replaced them? We do not yet know but TVC and similar research suggests that *the question is real.*<sup>19</sup>

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<sup>17</sup> Rubin (2002), Ibid.

<sup>18</sup> See Chapter 9 by Gordon, Beito and Tabarrok in Ben-Joseph and Szold (forthcoming) for discussions of all four topics.

<sup>19</sup> On the other hand, one author has criticized voluntarism because it undermines the governments' safety net (Poppendieck, 1999).

### III. SPONTANEOUS ORDERS AND THE BUILT ENVIRONMENT

In recent work, Nelson (forthcoming)<sup>20</sup> suggests that whereas the most significant development for the management of capital was the corporate form of governance, in the early 20<sup>th</sup> century, the most significant development for the management of land is the more recent rise of the neighborhood association in the late 20<sup>th</sup> century. Both are examples of successful spontaneous orders.

A recent discussion between Robert Nelson and William Fischel (2004)<sup>21</sup> suggests the following (I include areas of agreement as well as disagreement between the authors, identifying individual views where possible):

- Collective action to regulate the interactions of neighbors that might affect neighborhood quality has, since about 1970, increasingly been met by neighborhood associations.
- The actions and the goals of small municipalities and neighborhood associations are more similar than different.
- Privatization simply formalizes and extends, “... further a process of privatization of long-standing” (Nelson, p. 41). Both are in response to standard commons problems. Developers now supply common areas and facilities (“territorial goods” in the analysis of Foldvary)<sup>22</sup> and rules of governance. They do so in response benefits capitalized in land rents, market signals, obviating an old “market failure” analysis.
- Private associations have greater latitude of action, including voting rights more complex than “one-man-one-vote.”

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<sup>20</sup> Nelson, Robert H. (forthcoming) *Private Neighborhoods: A Revolution in Local Government*.

<sup>21</sup> Nelson, Robert H. (Summer, 2004) “The Private Neighborhood” and Fischel, William A. (Summer, 2004) “Revolution or Evolution?” *Regulation*.

<sup>22</sup> Foldvary, Fred (1994) *Public Goods and Private Communities*. Aldershot, UK: Edward Elgar Publishing.



- Private neighborhood associations can legally sell entry rights; an activity that zoning authorities pursue but have to mask.
- Nelson proposes changes in state laws that make it possible for inner city neighborhoods to privatize – and, thereby, become more exclusionary – becoming more attractive to residents as well as investors.
- The two authors differ as to whether neighborhood associations and (small) municipal governments are complements or substitutes. Nelson sees an evolution to a world of private community associations. Fischel notes that homeowners demand the protections afforded by both. He notes that owners want municipalities to limit the uses of undeveloped land near their homes and suggests, instead, a “golden rule ... Allow owners of undeveloped property to develop in ways that some previous landowner was allowed to develop the homes in which local residents now live.” The golden rule would limit NIMBY problems.
- A reform that both writers prefer would make secession from established cities easier.
- Fischel sees the proposed reforms as superior to many current proposals that, “want to go the other way ... They seek to consolidate local governments in metropolitan governments.” Yet, greater size cannot be presumed to fix anything.

Challenging the idea of regional governance of land, the discussion highlights the view that the use of land is *not* a "special case" exempt from the power of markets to fashion orderly and efficient outcomes. In fact, quite the opposite is true.<sup>23</sup> Just as Mises-Hayek demonstrated the limits of top-down economic planning, Jane Jacobs exposed the problems of top-down city planning many years ago. Top-down planners of all stripes are

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<sup>23</sup> Supporters of conventional zoning argue that it is required to mitigate externalities. Yet, they are also critical of the resulting land use trends. Their resolution of the paradox is to advocate more top-down controls, usually ones administered at the state level. This would head off suburbanization beyond the boundaries of metropolitan planners' control. Yet, even here people can still escape the controllers, as have those Portland residents who have moved across the river into Washington's Clark County (a Portland suburb). The way to rescue top-down land use planning, it appears, would be to have it administered at the national level.

seriously hobbled by their inability to tap diffused local knowledge, the sheer magnitude of which would in any event overwhelm them.<sup>24</sup> In a competitive market, local knowledge reappears,<sup>25</sup> lessening the dependence on politics and increasing flexibility; "public" goods (and spaces) in private communities and in shopping centers are provided more optimally; the capitalization of benefits in land rents more efficiently finances public goods provision; and market-tested rules of governance are developed. Private developers now routinely supply what had been thought to be "public" goods -- without the widely presumed market failure. Just as many people assert the inevitability of top-down planning because of external effects and information problems, events show the opposite: the inevitability of bottom-up approaches to these problems exactly as the Hayekian critique makes clear. It takes decentralized markets to generate the required information through trial-and-error learning. In the process, market participants are far more productive than top-down planners can ever be.

As governance moves to higher levels, the collective choice problem of democracy, the incentives individuals face to demand services when they think others will pay, becomes stronger. Yet, the mobility of factors (long thought to induce governments to respect property) has recently increased. In part, this is driven by technological developments and is likely to accelerate. The increased mobility of people and capital forces governments to compete. Private communities are part of this phenomenon, developed in Hayekian fashion to compete.

This view undermines the widespread emphasis on all sorts of "market failures" -- and the presumed benign corrective capabilities of politics and government. Rather, significant experience suggests that, "market-challenging" goods like roads, health insurance, unemployment insurance, police services, education, and law can and indeed have been privately provided.

Yet, there is more. A traditional attack on property rights centers on the premise of a conflict between self-serving behavior in the marketplace and

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<sup>24</sup> Top-down land use planners routinely prescribe higher densities. Not surprisingly, they have no way of being specific and actually specifying any particular density -- let alone make such recommendations for large numbers of parcels for many years into the future.

<sup>25</sup> Regions grow when local entrepreneurs innovate successfully. They do so by combining and recombining diverse local knowledge in novel ways. Desrochers, Pierre in (2001) "Local Diversity, Human Creativity and Technological Innovation," *Growth and Change*, 32: 3, 369-394, points out how this insight by Jane Jacobs has been overlooked by social scientists' emphasis on the benefits of specialization.

impulses towards civility and civic association. Communitarians argue that community and social capital are in decline and warn that a deficit of social capital is associated with a host of negative social consequences such as increased crime, poor economic performance, and political disillusionment.

It may be a mistake, however, to correlate this decline with "capitalism" as it also coincides with the rise of the welfare state which acted to crowd-out the private provision of many collective goods and social services. The critics may be wrong in more ways than one as it has been argued that the welfare state has sapped the virtues necessary for civility, civic association, *and* success in the marketplace. Rather than undermining community, civil society may take root in the commercial and communal spaces, facilities and institutions now taking shape in response to market demands.<sup>26</sup>

James Q. Wilson<sup>27</sup> has added that post-Victorian "self-liberation" is another long-term trend that evolution of civil society has to contend with. Yet, we are now also in an era of enhanced political participation by property owners in the direct governance of their major financial asset, their home. The primacy of local politics is well known and neighborhood association politics are as local as governance gets.<sup>28</sup> We do not yet know much about the links between these associations and civil society but the pairing appears to be a more promising solution to the crisis in civic engagement than New Urbanist spatial determinism which banks on mandated porches and bay windows to do the job.

## V. THE FUTURE OF CITIES

Most of the episodes discussed here, past and present, were not predicted by social scientists, nor do they does their provenance include the visions of top-down planners. Rather, the examples discussed evolved in a setting of flexible institutions and open-endedness. Cases where the reach of markets and civil society expanded have been welfare-expanding. While we cannot,

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<sup>26</sup> Brooks, David in (2000) *Bobos in Paradise: The New Upper Class and How They Got There*, New York: Simon and Schuster, devotes a whole book to the post-"me generation" synthesis of bohemian and bourgeois sensibilities. People's demand for community is alive and well and being met at Starbucks and similar chains.

<sup>27</sup> Wilson, James Q. (Fall, 1999) "Cultural Meltdown" *The Public Interest*, No. 137.

<sup>28</sup> New England town meetings are a venue to resolve political conflict *and* they are a source of community. Conflict and community are not mutually exclusive.

by definition, predict them, there is advantage to understanding how they came to be.

The voluntary arrangements of civil society are capable of producing a host of so-called public goods including aesthetic and functional zoning, roads, planning and other aspects of physical urban infrastructure. Civil society can also produce social infrastructure including education, conflict resolution, crime control and many of the social services often monopolized by the welfare state. Can voluntarism foster the broad range of civic resources in the modern age? Can it restore a “civic voice”? Can it foster the set of connections that enhance the economic as well as the non-economic sides of life? The weight of the evidence developed in *TVC* suggests a "yes" to all of these. The bottom-up refashioning of social relationships is promising.<sup>29</sup>

Humanity’s progress is, of course, uneven. Yet, advances over the last several hundred years in most people’s material condition have been stunning.<sup>30</sup> Having lived at subsistence levels for most of their existence, large proportions of humanity have only relatively recently advanced far beyond these levels. Such dramatic shifts are best explained by the identification of virtuous cycles, including positive feedbacks between prosperity and freedom. These provide the settings for people to experiment, to contract and associate voluntarily.

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<sup>29</sup> A similar view is expressed in Wilson, *Ibid.*

<sup>30</sup> McNeill, William H. in (1999) *A World History*, New York: Oxford University Press, places the beginning of the run-up at about 1000 AD when serious long distance trade (and associated interactions) became established in many parts of the world.