The Market and the Public Realm

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According to market theory, everyone benefits from free exchanges among individuals pursuing their own self-interest, because any voluntary exchange benefits both parties. But economists all admit that there is a defect in the market model: if two individuals make an exchange that benefits them both, they may have unintended effects on third parties.

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External Costs

This is what economists call external costs. To give a classic example, consumers may have the choice of buying products made in a factory that disposes of its wastes safely or in a factory that dumps its untreated wastes in the river. According to the market model, they act based on their own self-interest, so they buy the cheaper product from the factory that dumps its wastes, rather than buying from the factory that spends more to treat its wastes. But the wastes in the water may cause diseases and other costs for the people who live downstream that outweigh the savings to consumers from buying cheaper products. The producers and consumers of the factory's products ignore this unintended side-effect of their transaction.

Free-market economists often say we should use taxes to internalize external costs. In the example, there should be a tax factories that dump wastes which is equal to the cost of the health problems and other environmental problems that they cause to third parties. Then prices will reflect the total cost of the factory's products, including its external costs.

But these economists generally talk only about the most blatant environmental problems, such as water pollution and other forms of toxic pollution. They ignore more subtle external costs of the market that pose a much more fundamental challenge to their free market ideology.

The Market and the City

We can see the full impact of external costs by looking at the history of American cities during the last century, when the middle-class moved from streetcar suburbs to auto-dependent suburbs. In fact, government accelerated this trend through transportation and zoning policies that encouraged auto-dependency, but we will consider how a pure free-market economy would shift cities from streetcar suburbs with main-street shopping to sprawl suburbs with strip-mall shopping to see how external costs cause the free-market model to fail.

One hundred years ago, the American middle class lived in streetcar suburbs, which we now think of as the classic American neighborhood. They were made up of free-standing houses, usually on one-tenth acre lots, with sizable backyards, small front yards, and front porches looking out on tree-lined streets. Streetcars were used for commuting to work and for occasional trips to other parts of town, but everyone lived within walking distance of Main Street or of a neighborhood shopping street. You could catch a streetcar on the main street, but you could also find stores, doctors' offices, and other services right there. As astounding as it seems today, a carriage was a sign of wealth one hundred years ago, and middle-class Americans who lived in cities or suburbs did not own vehicles.

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But as the automobile became popular, these Main Street shopping districts suffered from inadequate parking, since there were only two or three spaces in front of each store. In the market model, each shopper acts based on his or her own self-interest. Given the choice between a 15 minute walk or a 5 minute drive to Main Street, most chose to drive - particularly when they had packages to carry home.

A 10 minute bicycle ride to Main Street might have been a convenient compromise, with a bicycle trailer when you need to carry packages, but high-speed cars made the streets seem so dangerous that most people were not willing to bicycle. It also became more dangerous to walk to Main Street than it had been when there were just a few low-speed horse-drawn vehicles.

This is an external cost that free-market economists generally ignore but that was important to the history of our cities. People drove because it was most convenient for them, and as an unintended side-effect of this decision, they made it more dangerous for people to walk or bicycle.

Because of its parking problems, shoppers tended to abandon Main Street in favor of new stores with parking lots. If a storefront on Main Street remained vacant for a long time, the property owner might decide to replace the old building with a new building that was set back from the street and had parking in front. The parking in front attracted potential customers who were driving by, and in the market model, the merchants care only about their own interest in attracting customers, not about the effect of this parking on the public realm.

But after several buildings on Main Street were replaced by new buildings with parking in front, Main Street was no longer an attractive place to walk. When several businesses on added parking in front to attract customers, all the businesses on Main Street lost their one advantage over the strip malls that they were losing business to: the interesting, pedestrian-friendly character that came from having an uninterrupted series of storefronts facing the sidewalk.

As Main Street lost businesses, people no longer had all the shopping they needed within walking distance of their houses. It became absolute necessary to own a car to do basic shopping.

Parking problems did not only affect Main Street. Ultimately, as more and more people owned cars, the residential streets of the streetcar suburb also suffered from parking problems. It happened first near Main Street, where shoppers parked on residential streets. Then it spread to other streets, because each house has only two spaces in front of it. If the house has a cottage in back, or if there are teenagers with cars as well as a car for each parent, or if people store cars on the street that they do not use, then these two spaces are not enough parking. In the market model, people decide to buy cars based on their own self-interest, and they do not think about the effect their decision has on the parking available in the public realm.

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To escape parking problems, people moved from streetcar suburbs to lower density auto-oriented suburbs, where each house and business has space reserved for off-street parking - but because they are lower density, distances are greater are greater in these newer suburbs, so most people cannot walk to shopping at all.

In the old streetcar suburbs, there was a 15 minute walk and 5 minute drive to shopping. In the new auto-dependent suburbs, it is impossible to walk and there might be a 15 minute drive to shopping.

Individual rationality - people pursuing their own self interest in the market - leads to collective irrationality.

The auto-dependent suburbs are no more livable and no more convenient than the streetcar suburbs were a century earlier, but they are far more expensive than the streetcar suburbs were. Housing is more expensive, because lower densities use more land, which drives up the cost of land in the entire region. Transportation is much more expensive transportation, because people have to pay the cost of driving for local shopping trips that people used to do by walking.

The combined cost of housing and transportation eats up a large chunk of family income. The Chicago-based Center for Neighborhood Technology recently developed an index of affordability that takes into account both the cost of housing and transportation, and they found that 61% of the neighborhoods in the United States are unaffordable, because it costs more than 45% of family income to purchase housing and transportation there.

Yet conservatives react to this economic burden by saying the high prices of housing are the fault of government regulation: we should eliminate regulations that protect open space near cities, unleashing the market to produce more housing. People are overburdened because they consume too much land and too much transportation, and conservatives say we should unleash the market to build housing that would make them consume even more land and even more transportation.

The Limits of Laissez Faire

It is surprising that laissez faire ideology remains influential long after it has outlived its usefulness.

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It was important to increase production by unleashing the free market in the nineteenth century, when the average American lived at what we now define as the poverty level. When American workers lived in tenements, there was an immense benefit to producing more housing.

But it becomes less important to increase production after people become economically comfortable. The streetcar suburbs were excellent places to live, and people are not significantly better off living on larger lots and driving longer distances.

After people have reached this level of economic comfort, increasing production is not as important as improving the quality of the public realm. A neighborhood that is a pleasant place to walk is more livable than a neighborhood where you have to drive to a strip mall to shop, even though the auto-dependent neighborhood involves more consumption.

Discussions about the free market need to recognize this obvious fact: The market is a superb mechanism for creating wealth, but it tends to degrade the public realm. Wealth is not everything, and those of us who live in the nations where most people already have enough are better off if we put political limits on the market to protect the public realm.

We recognize the major threats to the public realm, such as global warming and oil spills. If we also recognize how the market has degraded our neighborhoods and our everyday life, we will be able to limit the market politically and use it for our own purposes, rather than being controlled by the market.