

## CHAPTER ONE

# The Amazing World of Markets

## A TRIP TO THE MARKET

Few Westerners visit the dusty industrial city of Lanzhou, on China's Yellow River. Even fewer venture up the narrow dirt road that I am on today – which is home to one of the city's street markets. It is lined with stalls, their thin wooden poles supporting roofs and walls of dingy fabric. From beside one of them, a small boy stares at me in amazement, then runs in excitedly to report this strange sight to his mother.

She sits, by a spring balance twice her age, in the cramped space that remains behind all her stock: sacks of rice, grain, sunflower seeds and nuts, and above them a rickety shelf crowded with bags full of brightly-coloured spices – which prospective customers are sniffing and tasting, before checking out the next dry-goods stall.

*Plastic baths of water, full of live fish,  
jut into my path.*

The boy still stares, still goggle-eyed. But I press on purposefully. The next stall is piled high with melons, bananas, pomegranates, limes, ginger, leeks, potatoes, beans, maize, cauliflowers and strange vegetables. The stallholder, a young woman with long black hair, is scrubbing one such vegetable over an enamel bowl full of water.

A bell rings behind me. I move smartly out of the way of a bicycle pulling a steaming brazier, the size of an oil drum, from which its owner sells hot soup.

I walk on. Plastic baths of water, full of live fish, jut into my path. Next, there's a stall with wooden cages full of live chickens, ducks and pigeons. Then more fish, this time in steel pans. Then someone selling underwear. Next, a hardware stall with countless woks, earthenware jars, glasses, rice-bowls in tottering stacks, brushes of all shapes and colours, dustpans, buckets and more. A second bell heralds another bicycle, this one carrying a precarious pile of squashed-up cardboard boxes that someone is taking for recycling, all bearing Chinese lettering in garish colours. Meanwhile, smoke drifts across from a stall with hot food (it's best not to ask what) sizzling on a gas stove that is well past pension age. Another stall offers cakes of various sizes and colours, nestling incongruously alongside sausages, hens' feet, rolled meat, fishcakes and balls of – well, again, I am not really sure that I want to know.

## **NO WORDS, BUT MUTUAL BENEFIT**

I have reached my goal: a tiny wooden kiosk with no door and a large unglazed window. Inside sits a young, attractive girl in a red shirt, the street market's only seamstress. She has no sewing machine – though one day, perhaps, she will have saved enough to buy one – but she stitches by hand with great precision.

We cannot speak each other's language, but I hand her the slacks that I am holding, and show her how the hems have come adrift. She grasps my meaning immediately, and

nods exaggeratedly – as if to make plain, even to someone unlucky enough not to be born Chinese, that she understands. I want to know the price: so I point to my palm with a puzzled expression on my face. She holds up five fingers, which I guess means five Yuan. That's probably way over the going rate, but to me it's a tiny sum and I would much rather pay it than waste time looking for another seamstress.

*Barefoot children gather to stare  
at this strange creature.*

I nod. The slacks are plucked from my hand, out comes the needle and – worryingly – some rather garish pink thread. I stand outside – there is no room for two in her small workspace – and look around as I wait. Further from the main thoroughfare, the stalls give way to people selling fruit, vegetables, oil, rice – even underwear – from carts. Further still, vendors sit on the ground, their goods spread out on a simple sheet.

Barefoot children gather to stare at this strange creature that has landed among them. But within minutes, my hems are neatly stitched, without a speck of pink thread to be seen. I gladly pay the agreed fee, and leave with much mutual smiling and nodding. I seem to have made her day – though I hope it's because I'm exotic, not because I have overpaid. And she has made mine: I can now attend my evening banquet without safety pins in my hems.

I have learned a lot, too.

## MARKETS ARE EVERYWHERE

For one thing, I have confirmed my belief that *markets are everywhere*. China is still supposed to be a communist country, but even here I have found markets just like those in Europe or America. The goods on sale may be far stranger (and the vendors perhaps less strange: there are few sights more colourful than a stallholder in London's Petticoat Lane market in full cry). But otherwise they are no different – a huge variety of goods and sellers, from which a throng of customers somehow make choices.

*Choice* defines markets, even in an authoritarian country like China. The girl in the red shirt was not forced to mend my hems; nor was I forced to accept her price. Either of us could have vetoed the bargain – she deciding to wait for another customer and me looking for a repair somewhere else. You can't call something a *market* unless both sides can simply walk away.

***There are few sights more colourful than a  
Petticoat Lane stallholder in full cry.***

But we didn't walk away, because there was *mutual benefit* in this exchange. To me, five Yuan was a small sacrifice for the benefit of looking smart. To her, it was a good reward for a few minutes' work. In this way, as we will see

in Chapter 2, the market brings about a calm *cooperation* between people who *specialize* in different things that they are good at – she on her skill with a needle, for example, and I on my economics.

Indeed, the greater our *differences* – like my uselessness at sewing and the fact that, on my travels, I lacked the simple *specialist tools* for the job – the easier is it for us to cooperate. We did not need to debate how important my repair was, or have a public vote on whether it should be done. We did not need everyone to agree that the repair would benefit society. In fact it was our very *disagreement* about things – she valued my money more than her time, I valued her skill more than my money – that brought us together. All we had to agree on was price. Beats politics as a way to get things done, doesn't it?

## NOBODY'S PERFECT

Markets are human. They're never perfect. If you own an economics textbook, you should rip out the section on 'perfect competition' – the one that describes the perfect balance that prevails in markets when vast numbers of individual producers sell identical goods to vast numbers of individual buyers, all of them completely aware of every price paid in every transaction. That's not 'just a theoretical abstraction' – that's just plain *daft*. As Chapter 2 explains, it's their very *imperfections* and *imbalances* that make markets *work*.

I'm sure there are indeed vast numbers – millions – of individual seamstresses in China. But a stranger like me would have a hard job finding them, never mind comparing them all. As Chapter 3 shows, such *information* is the grit in the market oyster. Information isn't free and perfect. Buyers have to spend time and energy seeking out the sellers they prefer, and sellers have to spend time and energy attracting buyers. If all buyers were perfectly informed, advertising executives would all be out of work. (And we wouldn't want that, would we?)

***It's their imperfections and imbalances that  
make markets work.***

I too had to spend some effort in looking for someone to do my repair. In my case this *search cost* (as economic jargonauts call it) was pretty minor, but if you were buying something expensive – like a house or a car – you would want to look around more widely, and spend quite a lot of time and care on your selection.

You'd probably want to spend time drawing up a contract, too, just as I had to spend some effort explaining what I wanted and finding out the price. These are called *transaction costs*. Without them, lawyers would be out of work too (but that's life, sadly – things are never perfect).

## **TIME, PLACE AND TRUST**

So I worked on the basis of incomplete information. I knew there was a group of older needlewomen who

squatted on a street corner a few blocks away. But I had walked enough, and it didn't seem worth bothering to check them out. Anyway, I had more *trust* in my red-shirted friend: the fact that she could invest in her own little kiosk suggested that the quality of her work attracted a stream of loyal customers.

These differences of *time*, *place* and *trust* (detailed in Chapter 6) all affected my choice. But it's these differences that drive markets. To me, these sellers were *not* identical. There were even differences in the spices on sale in the market, which discerning customers sniffed and tasted, before crossing over to check those on other stalls. Perhaps some were fresher, others cheaper. Or perhaps some stallholders had a more useful selection.

With such choosy customers, sellers face the constant threat of losing trade to other sellers – which makes them strive to deliver the range, quality and price that people actually want. The *competition* (as Chapter 5 will show) doesn't have to be 'perfect' – having even two similar traders within striking range of each other is enough to keep them sharp. Sometimes the mere *threat* of competition is enough.

## WHO? WHAT? WHERE? WHY?

This all means that markets are a continuous voyage of *discovery* for both buyers and sellers. Buyers are constantly tasting the spices, smelling the soup, squeezing the melons, tapping the glassware, checking the prices, and deciding



which sellers they trust. Sellers are always adjusting their prices in response to how much customers are prepared to pay, and what competitors are charging. There is nothing static about this: when you see the word ‘equilibrium’ in your economics textbook, take a marker pen and blot it out.

***When you see the word ‘equilibrium’ in your economics textbook, take a marker pen and blot it out.***

Yet the fact that some traders stay in business year upon year suggests that they are doing something right, and that customers are willing to pay for what they produce, rather than just looking, sniffing, tapping and moving on. Somehow, this discovery process matches up *supply* and *demand* – telling sellers what to produce in order to satisfy the constantly changing, and highly personal, demands of their customers.

***The entrepreneur always searches for change, responds to it, and exploits it as an opportunity.***

**– Management guru  
Peter F Drucker**

Getting that right demands a bit of flair. You need to guess what buyers might go for, and give it a try. You have to be a bit of an *entrepreneur* – take a chance, invest your time and money in something new that might work, or might not – like those clever cyclists who pedal soup to their customers, or calculate that someone will actually pay hard cash for used cardboard boxes.

## UNORGANIZED ORDER

Markets might look like chaotic places – my Lanzhou street market is a river of people, with noise, smoke and clutter – but they are not. There’s certainly no central, controlling authority. People here aren’t told what to sell or what price to sell it at (a subject for Chapter 4). Rather, they just gather together and hope they are offering attractive goods at attractive prices. The market doesn’t succeed because some authority directs it. It succeeds because its participants follow a *set of rules* that have worked for centuries.

Consider *property rights*, for example. The stallholders’ goods (or services, like the time and skill of my seamstress) are theirs. My cash is mine. If they succeed in attracting lots of customers, they get to keep the proceeds. If I don’t pay, or they swindle me, that breaks the rules. For markets to work, people’s property has to be *secure*.

***If I don’t pay, or they swindle me, that’s against the rules.***

These rules are so natural to us that most everyday transactions don’t require legal documents or contracts. They are done on trust. The customers who buy the strange vegetables or the hen’s feet in the market simply expect them to be wholesome (well, as wholesome as hen’s feet can be): if not, they might demand a refund, or vow never to return to that stallholder again. Likewise, seamstresses

trust that when they've handed back your repair, you won't just run off without paying. Those are the rules.

But life isn't perfect. Sometimes, people's property is harmed by what others do. The underwear seller's stock would be devalued, for example, if the smoke and smell from the food stall drifted on to it. And the general human congestion in this narrow street means it can take some time to get to the stall you're looking for. These *externalities* (in the jargon) can be hard to deal with, but as we'll see in Chapter 7, the market often finds ways to do so. In Lanzhou, the food and the clothes sellers seem to have done it simply by making sure that they are some distance apart.

## MARKETS ARE A FORCE FOR GOOD

It seems strange that this system – with no overall directing authority, where people come to sell or to buy, purely with their own interests in mind – actually works so well. But it does, precisely because it enables different people with different purposes and opinions to cooperate peacefully, and because it steers resources quickly and efficiently to where people need them.

Certainly, the market has to answer moral concerns (see Chapter 8) such as the fact that it doesn't leave people perfectly equal. My seamstress is much poorer than I am, for example. And yet, thanks to the market system, she and other people in China are catching up fast, their

standard of living doubling every five years. The market system is the most powerful anti-poverty device, and the best wealth-creator, on the planet. That is why you find markets (almost) everywhere.

And there are markets in just about everything. In goods (vegetables, spices, cars); in services (plumbers, teachers, cleaners, actors, prostitutes); in housing; and in financial assets like shares and currency. There are even virtual, online markets like eBay, explored in Chapter 9. Indeed, market exchange is so universal that the word *market* has come to cover the whole idea of exchange – not just the place where people stand around trading things (see box).

## GETTING RESOURCES TO THEIR BEST USE

On a corner near the street market in Lanzhou is an even stranger market. Men sit around – dark-skinned country people who look older than their years. Some have sledgehammers beside them; others, spades; still others, pickaxes. A few of them shoulder paint rollers with improbably long handles. Beside each, as they squat playing cards, is a piece of cardboard bearing a short, hand-written commercial for their qualities as labourers. They come to town each morning in the hope that someone will hire them for a few hours or days.

It's an informal *labour market*. They are not selling goods, but their services. They gather here so that anyone who needs workers knows where to find them, and can do

## What's in a **name** market?

What image does the word *market* conjure up in your mind? Perhaps the obvious one is the image of people congregating, maybe on a set day of the week, to buy and sell things such as food or livestock. Or perhaps you think of the actual building where this trade goes on: like England's impressive nineteenth-century corn markets (which still exist, though mostly as entertainment venues).

However *market* has a more abstract meaning too. It suggests the whole economic activity of buying and selling. And the trade in a particular good or service – like *the insurance market* or *the oil market*.

When you offer something for sale you are said to *market* it. The word also covers the particular group of people you want to trade with – as in *the youth market* or *the tourist market*. It also means the *demand* for particular things, with sellers talking about a *thin market* or a *strong market*. And the price of things that are traded, as in *the market was up today*.

Useful word, *market*. Almost as useful as the real thing.

so easily without having to scour the neighbouring villages. Their chosen spot is near to yet another kind of market – a lattice of streets lined with steel sheds from which is sold every conceivable DIY essential – wood, fixings, baths, radiators, air conditioners, pipes, wire, bricks, tiles, windows, drills, spades, light fittings, paint, ladders, locks and more. They know that the customers here may need people to help dig the drains or paint the ceiling. How convenient that there is a labour market nearby!

Convenient, but not coincidental. The free-exchange system has an uncanny power to steer the right resources to the right place at the right time.

But that's the miracle of *markets*.