

I deal with reality, possibility and what is desirable ...

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People sometimes wonder why I get so frustrated with some of the commentators on this blog who usually start off appearing reasonable, gradually disclose a free market, and often Hayekian bias, and end up effectively taunting on the basis that I will not accept their free market view of the world, which by their definition means that I am necessarily wrong. At this point I get bored and break off engagement as a complete waste of time and the rest is, I am sure, familiar to those who sacrifice their time to read such comments.

In that case then I think it worth explaining just why I find free market economics so frustrating. Fundamentally this is because of the absurd assumptions that underpin the logic of those who adhere to these beliefs. Saying that, many of those who do so will, I am sure, say that what follows represents beliefs they do not personally recognise. I hate to disillusion them, because the reality is that all this will reveal is that they are the unwitting slaves of some far from defunct economists because what I will describe are the assumptions that underpin the vast majority of economics journal papers in the UK, including those that result in the policy prescriptions of almost all free marketeers (including, depressingly, on tax).

So what are these assumptions? You can give and take a little on these, because once you get above about eight there is some overlap or substitutability between them, but each is common and worth noting. I should, in fairness, [add I started with a list from here](#), but expanded a little as I thought appropriate. Free markets to work require that there be:

- * Many sellers each of whom produce a low percentage of market output and cannot influence the prevailing market price.
- * Many individual buyers, none has any control over the market price
- * Perfect freedom of entry and exit from the industry. Firms face no sunk costs and entry and exit from the market is feasible in the long run. This assumption means that all firms in a perfectly competitive market make normal profits in the long run.
- * Homogeneous products are supplied to the markets that are perfect substitutes. This

leads to each firms being “price takers” with a perfectly elastic demand curve for their product.

- * Perfect knowledge — consumers have all readily available information about prices and products from competing suppliers and can access this at zero cost — in other words, there are few transactions costs involved in searching for the required information about prices. Likewise sellers have perfect knowledge about their competitors.
- * Perfectly mobile factors of production — land, labour and capital can be switched in response to changing market conditions, prices and incentives.
- * No externalities arising from production and/or consumption.
- * Markets that clear, which requires that for all sellers there is a buyer.
- * Markets that reach a state of equilibrium i.e. there is an optimal outcome to economic activity.
- * Rational expectations, which means that people accurately forecast statistical expectations and all errors are random.

As I have said, you can argue that one or two extra conditions can be added to this list and that a couple may overlap. It does not make a lot of difference to the outcome because the fact is that all these conditions need to exist simultaneously if markets are to provide optimal outcomes for the economic organisation of society. If any one of them fails then because of the simple application of chaos theory and the power of small numbers the outcome from leaving markets to themselves are wholly unpredictable.

So what is the chance that these conditions exist? This is a question Prof Richard Werner asked last week [at the meeting I was at in Glasgow](#). Let’s be generous and suggest that each of these conditions has a more than evens chance of existing — call it 55%. But remember, they all must. In that case them all existing is 0.55 to the power 10. That is about 0.25%. But that’s incredibly generous: ludicrously so when the assumptions made are looked at by any sane person. Apply a more likely probability of these things existing of 5% (which I still think absurdly high) and the chance that free markets exists falls to 0.00000000001%. Let’s call that a cat’s chance in hell.

This is why I find free marketeers so absurd. They demand that markets be given freedom to deliver when there is quite simply no chance at all that they can deliver because the requirements that must exist for them to do so not only do not exist, but cannot do so.

There is no chance of there being multiple sellers in many markets. Monopolies are a reality. And so too are monopsonists (sole buyers).

Perfect freedom of entry to markets will never happen: it depends a socialists utopia of everyone having equal capital for a start.

Third, no one has perfect knowledge, or rational expectations come to that.

And the idea that markets are in equilibrium is absurd: we only ever progress towards a goal. We have never yet reached it.

I could go on, but the fact is that all these assumptions can only be held by someone wholly out of touch with reality or an economist (and there's a Venn diagram in there, with a massive overlap, of course).

So the reason why I can't be bothered to engage with those who persist in arguing that free market outcomes are possible is that it's absurd to do so. The premise of their arguments is false. Why move engage in debate on that basis?

The fact is that we cannot have markets without regulation.

And we cannot have markets without the state playing a significant role in determining what they can and cannot do.

And free markets cannot ever be free then, as a matter of fact. We can only talk about constrained markets where foreseeable outcomes must be within a limited range of potential outcomes to protect all those who might otherwise be harmed. Nothing less than that is ever going to be acceptable in a modern economy. But don't get me wrong: the outcome of those constrained markets is invaluable. I believe, very strongly, in a mixed economy. But free market thinking is a ong way removed from that an is absurd, wholly unrealistic and, bluntly, a rather sorry fantasy.

People can argue otherwise, but they can do it elsewhere. I deal with reality, possibility and what is desirable and free markets fit into none of those categories.