Editorial

On markets in economic theory

Although general equilibrium is commonly considered to be a theory of markets under perfect competition, it does not explicitly include any formal representation of marketing mechanisms or institutions. The implication is that its direct relevance is limited to a representation of equilibrium under pure barter in an economy consisting solely of producers and consumers. Exchange of commodities, however, frequently, if not usually, takes place through mediation mechanisms or mediators; the former including advertising, inventory, sales, and purchasing departments within producing firms; the latter consisting of commercial firms such as ‘brokers’, ‘specialists’, ‘traders’, etc. The failure to recognize these institutions has left the distinction between firms and markets quite vague. For example, Coase poses the fundamental problem of industrial organization as that of explaining the conditions under which transactions take place within firms or in markets. But mediators are firms, or parts of firms. They are organized so as to make a profit by mediating indirect exchange among producers and consumers. Barter involves direct exchange with a double coincidence of wants in the goods exchanged. More prominent market forms include stores, sales departments, and brokers. Stores are inventories on display that use price adjustments and advertising to coordinate the flow of producer supplies and consumer demands. Sales departments within firms use order–backlog and price adjustment rules to mediate supplies and demand while brokers and specialists, usually organized in marketing firms, mediate the bid/offer orders of potential buyers and sellers, determining current prices at any one time using inventory or order–backlogs as buffers. These institutions create a double coincidence of wants by enabling each buyer or seller to use goods on one side and money on the other.

These points have been made before but theorists and experimenters have largely neglected this important aspect of the modern economy. The papers in this issue make highly original and significant advances into this relatively unexplored domain; by Pingle, who uses an experimental laboratory setting; by Dawid and by Howitt and Clower using computer models. Together their work demonstrates conditions under which mediators form spontaneously within a pure barter economy and provide clues about their contribution to economic efficiency and stability. Their references contain earlier contributions from the rather sparse literature on the subject.

R. Day

The Editor, Department of Economics, University of Southern California, Los Angeles, CA 90089-0253, USA