Freedom and Liberty: Perspectives from 21st Century Economics

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Oxford

May 2023

Discussions of freedom and liberty—and their relationship to the economic system—have moved up front and center

- Russian invasion of Ukraine
- Many on the Right have resisted mask and vaccination requirements as an infringement on their liberty
- Growth in libertarianism, especially in US
  - Partially reflecting a lack of trust in government and collective action more generally

Economists have long been engaged in debates about freedom and its relationship to the economic system

- Mills' *On Liberty*
- Friedman's *Free to Choose* and *Capitalism and Freedom*
- Hayek's *The Road to Serfdom*

Claim of Hayek and Friedman was that

- "Free markets" and "free enterprise" were the best way to promote economic wellbeing *and* individual freedom
- There were moral justifications behind market-driven distribution—the theory of just deserts
- Essential for maintaining political freedom

Each of the claims is suspect

- Terms like “free markets,” and “free enterprise” are used deliberately to bias the discussion
- Advances in economic theory and experiences with neoliberalism over the past forty years have exposed the limitations in these earlier analyses, and suggest an alternative economic framework that does better in enhancing individual freedom, political freedom and societal well-being
- Important for progressives to reclaim the “freedom agenda”

Broad economic perspective

- Liberty is about a person's *freedom* to act.
- Changes in a person's opportunity set—the set of options available—affect a person's freedom to act.
- Any reduction in the scope of actions that can be undertaken is, in this sense, a loss of freedom.
- From the perspective of an economist, the language surrounding this loss makes no difference.
  - A regulation with a fine for violating the regulation is a change in the opportunity set
  - The regulation might be viewed by some as "coercion"
- All that matters is the set of available options from which the individual can choose.
  - Labeling it as an "incentive" doesn't change reality
  - But note: behavioral economics (discussed below) suggests it *may* make a difference

For any society to function, there must be regulation and collective action

- Ten Commandments were a simple set of regulations

    But this is even more necessary in a complex modern, knowledge-based, urban economy

- Cities couldn't function without stop lights

    One person's actions affect others—in ways in which they may not fully take into account

- Economists refer to these as externalities
- **One person's freedom can be another person's "unfreedom"**

Or as Isiah Berlin put it:

"Freedom for the wolves has often meant death to the sheep."

Conflicts of freedoms

- Right to carry a gun threatens another person's right to live
- Right not to get vaccinated or wear a mask threatens others' right not to get a disease, or even to live
- Right to pollute threatens others' rights to live a healthy life

In each of these cases, society has to make judgments

- In each of these cases, I believe most would agree on how these "liberties" should be balanced

But similar trade-offs are pervasive:
Freedom and Distribution

- Libertarians/conservatives argue that taxation is a deprivation of liberty—of the right to spend one's money as one pleases
  - Claim: Taxation is coercion, even when there is some form of representation
    - ("Taxation without representation is tyranny")
  - Taxation constricts the individual's budget constraint, constraining what he can do, his opportunity set

"Just desserts"?

- But such claims give primacy to the distribution of income generated by the market
  - To argue that there should be no government intervention in budget constraints is to argue that there is something sacred about market prices and initial endowments
    - The fact that intervention comes from government rather than as a result of market forces doesn't really change things
  - Moral claims are based on neoclassical theory: "just deserts"
    - But such claims are hard to maintain, even were markets to work perfectly
      - Distribution of wealth is based on intergenerational transfers of advantage and disadvantage
        - Moral legitimacy depends both on the legitimacy of parents' wealth and the moral legitimacy of such transfers
      - Consider case where a few individuals inherit a large fraction of a country's wealth from parents who acquired that wealth by taking it from others (the case of landowners in many countries where European colonizers displaced the previous inhabitants of the countries that they occupy today)

"Just desserts"

- Libertarian perspective provides no justification for why the initial "endowment" (distribution of assets) is "natural," and the incomes so generated not to be deviated from
  - While it is true that there may be strong moral and economic arguments that those who work more or save more should be rewarded for their work or savings, even in perfect competitive markets, the *magnitude* of those rewards may have no fundamental moral justification
  - Competitive prices have no more moral justification than the distribution of wealth
    - Market returns are affected by wealth distribution; and if there is no moral legitimacy to wealth distribution, how can there be moral legitimacy to the returns so generated?
    - In example above, those individuals then determine in today's competitive markets what is valuable and what is not—and therefore whose income is high and whose is low

A further critique

- Markets don't exist in a vacuum
  - They are shaped by laws, rules, and regulations
  - Contract law, property rights, intellectual property rights, bankruptcy law
- These are not a matter of "natural law" but are social constructions
  - They can and do take on many different forms
- The choice affects the distribution of income and wealth
- Choices are typically shaped in political processes where power matters—no moral legitimacy

Reference: J. E. Stiglitz, *Rewriting the Rules of the American Economy: An Agenda for Growth and Shared Prosperity*, with Nell Abernathy, Adam Hersh, Susan Holmberg and Mike Konczal, 2015

The efficiency argument is even more suspect

- Central to perspective of Friedman, within a standard equilibrium framework, and Hayek, within an evolutionary framework
- But markets are never efficient, even in the limited sense that economists use that term (no one can be made better off without making someone else worse off)

The failure of unfettered markets

- Obvious that unfettered markets, or even inadequately regulated markets, lead to socially undesirable outcomes
  - Opioid crisis, created in no small measure by drug companies and pharmacies exploiting those seeking relief from their pains
  - Cigarette companies making addictive and lethal products
  - Financial companies bringing on the financial crisis that caused so much economic devastation
  - Multiple scams preying on the elderly and others
  - Oil and coal companies making billions as they endanger the future of our planet
- **Any theory of liberty and freedom, such as that of Hayek or Friedman, that rests on the contention that markets on their own are efficient and not exploitive obviously rests on a weak reed**

Expanding opportunities

- In a society with a fixed amount of resources, expanding one individual's budget constraint—enhancing the freedom to spend—necessarily entails constraining others'
- Taxation can expand the opportunity set of one individual—increasing that person's "freedom to act"—as it contracts the opportunity of another
  - Expanding opportunities by providing health and education to the poor can expand their opportunity sets far more than it contracts the set of those being taxed—enabling them to more nearly live up to their potential
    - Perspective consistent with that of Amartya Sen in *Development as Freedom* focusing on interventions that expand individuals' capabilities, and thus their opportunity set, their freedom to act
  - Recent research has also emphasized that there are externalities associated with inequality: It undermines economic performance (see, e.g. Stiglitz, *The Price of Inequality*)
- Society has to make judgments about the trade-offs

Exploitation and freedom

- Markets are marked by exploitation
  - Exploitation of market power
  - Exploitation of the vulnerable and imperfectly informed
- Again, a trade-off: The right of corporations to exploit vs. the right of others not to be exploited
  - Exploitation of market power by monopolist constrains consumers' opportunity
- Broad consensus that exploitation should be constrained
  - In spite of loss of "liberty" by monopolist
- Both moral and efficiency grounds
  - Particularly evident when extreme cases (monopolist has control over something necessary for life itself)

Coercion, public goods, and the free-rider problem

- Public goods (like basic research, investments in infrastructure, and education and health) can expand the opportunity sets for all
- In the case of pure public goods (like knowledge), there are incentives to be free riders
- Need coercion—forcing people to pay
- But even with such coercion, everyone's opportunity can be expanded—in a sense, the "freedom to act" has increased
- **Coercion can enhance freedom**

Sometimes coordination involves very little (or no) sustained coercion—with enormous benefits

- Driving on the right (or left) side of the road
- Without coordination there can be a disaster
- Once the rules are set, easy to sustain

Seemingly non-coercive ways of altering behavior

- Modern behavioral economics explains that behavior may be more effectively affected by changing beliefs, perceptions, and preferences than by changing constraints
  - Inducing individuals not to litter: "the right thing to do"
- "Socialization" (the social formation of preferences to be "other-regarding") can also induce individuals to internalize externalities
  - To the extent that a social order succeeds in doing so, there may be less need for seemingly more coercive public interventions to regulate externalities (though, to be sure, some would argue that the social pressure itself is coercive)

Peer pressure and social sanctions as social coercion

- Social sanctions or peer pressure can also be viewed as imposing constraints on freedom
- Harder to assess what to do about it—or even whether something should be done
  - Though we see how they affect an individual's perceived freedom of action, the societal changes required to expand individual freedom involve changes in mindsets
  - Education and better understanding of the way our preferences are shaped and our actions are affected by peer pressure can be "freeing" – one of the purposes of a liberal arts education

Social coercion vs. social cohesion

- Perhaps analogous to weak distinction made earlier between “fines” and “incentives”—all that matters is change in opportunity set
- Is this, at least in some instances, a distinction without a difference?
- When social coercion is directed as internalizing externalities, both alter behavior in a pro-social way

Freedom, the media, and economic and political power

If perceptions, beliefs, and preferences can be altered by the media, then society faces an important set of decisions

- Who gets to control the press—and gets to control, or at least shape, societal meta-narratives
  - With a loss of *effective freedom* on the part of others
  - Should it be based on wealth?
    - Enabling the wealthy to advance (through economics and politics) their interests
    - Further constraining the "freedom" (choices) of others
- What regulations should be imposed on the media, including the social media, to prevent, or at least reduce, social harms?
  - Restrictions that affect virality

- In each of these cases, there are trade-offs, no absolutes
- But I suspect that constructing "the good society" would entail more regulations and less ability of the wealthy to dominate in the shaping of beliefs and preference

Tolerance—a key Enlightenment idea and ideal

- Central in earlier perspectives was that one person's *views, beliefs* about what is desirable or good should have no bearing on what is allowed, encouraged, or discouraged.
  - Only actions should matter (at least as for public policy) and only actions that *directly* adversely affect others (not actions that others might disapprove of)
- The Right, at least in the United States, has repudiated such notions of Enlightenment tolerance (as they have walked away from other Enlightenment values)

II. Neoliberal Capitalism and Freedom

Review:

Friedman and Hayek's views that capitalism enhanced individual freedom were flawed both because their analysis of individual liberty in an interdependent society was flawed, and their understanding of economics was even more flawed

- Unfettered markets were not competitive or efficient (or stable)
- Maximizing shareholder value did not maximize societal well-being
- Underestimated or ignored a host of market failures (externalities, imperfections of information, incomplete markets, etc.)
- Underlying model of the individual was flawed—well defined, fixed preferences, rational and perfectly selfish well-informed individual

Friedman, the apostle of free markets, claimed they were efficient and enhanced freedom, e.g. in his book *Free to Choose*

- Those with limited income are *not* free to choose
  - They do what they can to survive
- Unbridled capitalism that these ideas gave rise to is perhaps better described by *Free to Exploit*

Hayek's evolutionary theory

Hayek's evolutionary approach is equally flawed

- Claim was that the dynamics of markets, the evolutionary process, would lead to better outcomes, a wealthier society
- But claim was simply an assertion, not based on any economic analysis
- There is no teleology in evolutionary processes
  - There is *no* presumption that they result in the overall long-run dynamic efficiency of the economy—quite the contrary

Critical questions:

- What kind of society (economy) most likely to enhance the "freedoms" of most citizens?
- What kind of society (economy) most likely to sustain political freedom and democracy?

Neoliberalism argued that *freeing the economy* (stripping away regulations, reducing the size of the state, giving full reign to unfettered markets) would lead to high growth; trickledown economics ensured that benefits would be shared by all

- Forty-year experiment has led to lower growth and more inequality, with those at the bottom in many countries seeing real incomes fall
- Disillusionment has understandably led to growth of populism
- Setting us off *on the road to fascism*

Progressive Capitalism and Freedom

- There are alternative ways of organizing society that can do a better job of enhancing freedom—progressive capitalism (or a rejuvenated social democracy) (described more fully in my book *People, Power, and Profits)*
- With a better balance of market and State (collective action), with a rich ecology of institutions (including cooperatives and not-for-profits, and government provision of a "public option")
  - Most successful US institutions are not-for-profit universities and research institution
  - Emblematic of for-profit educational institutions is Trump University

Greater efficiency and equity—more "freedom to choose"

- As a result of doing a better job at reducing negative externalities through better regulation, investing in public goods, and correcting other "market failures"
  - Externalities and public goods are especially important in 21st century economy—high level of urbanization, a knowledge economy
  - But market failure approach has been rightly criticized: Why should we begin with a presumption that markets are the right solution, when we know that there are such pervasive failures?
  - **Other important "collective" roles**
    - **Limiting a variety of forms of exploitation**
    - **Providing social insurance**
    - **Better risk management enables more risk taking, more innovation**

Shaping individuals in a different way

- Current economic system shapes individuals—to be greedy, selfish, with limited concerns for others
- Cooperatives may help shape individuals to be more cooperative, other-regarding, and to enhance social cohesion
- With such other-regarding behavior and greater social cohesion, need for more obtrusive forms of coercion to deal with negative externalities is reduced

Difficult philosophical problem

- With endogenous preferences economists' standard individualistic welfare framework breaks down
  - Which preferences (utilities) are we supposed to be maximizing?
  - Positivist framework, with a focus on Pareto efficiency, has been at center of normative analysis for a century
    - Discussion of Pareto efficiency enabled economists to avoid interpersonal utility judgments or judgments about what makes for a good society
    - Made economics a more technocratic subject
    - Though in practice, economists had to go beyond this framework
- Recognizing endogeneity of preferences forces us to make judgments about trade-offs (do we care more about enhancing the wellbeing of the poor than constraining the wellbeing of the rich?) and consider what we mean by a good society (do we want our children to be selfish, greedy, and dishonest?)

Concluding comments

- With greater investments, including in public goods and individuals' capabilities, better management of negative externalities, better social insurance, and stronger social cohesion, progressive capitalism can enhance individual freedom far more than the kind of unfettered capitalism that Hayek and Friedman advocated
  - Doing a better job of creating the "good society"