

The Road to Freedom: Economics and the Good Society

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Discussions of freedom, liberty, and the rules of law— 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
- Trump trampling the rule of law (both domestically and internationally) and human rights

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
- Economic “freedom” 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 to enhance individual freedom, political freedom and societal well-being
- Important for progressives to reclaim the “freedom agenda”

Outline of talk

- I. The meaning of freedom/liberty
 - A. Basic Concepts
 - B. Tradeoffs: one person's freedom is often another's "unfreedom"
 - C. How good regulations—some coercion—enhances freedom
 - D. The desirability in a free society of progressive taxation
 - E. Critique of moral and efficiency arguments of Hayek and Freidman
 - F. Social cohesion and the internalization of externalities
 - G. The importance of a democratic media
- II. What kind of an economic and political system delivers freedom?
 - A. The failure of neoliberalism
 - B. "Progressive capitalism" as an alternative

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.
 - An individual at the point of starvation has no real freedom—he does what he has to do to survive
- From the perspective of an economist, the language surrounding this loss makes no difference.
 - All that matters is the set of available options from which the individual can choose.
 - Labeling something as an “incentive” or describing a regulation as a fine 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

- The Ten Commandments were a simple set of regulations
 - But this is even more necessary in a complex, modern, knowledge-based, urban economy
- **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."

- Economists refer to these as **externalities**, and they are pervasive and ubiquitous
 - Both positive and negative
 - Especially important as we become more urbanized and push against our planetary boundaries

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 there are many instances where resolution of trade-offs is more difficult

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 she can do, her opportunity set

Expanding opportunities

Redistributive tax and expenditure policies expand the opportunity set of others

- In a society with a fixed amount of resources, expanding one individual's budget constraint—enhancing the freedom to spend—necessarily entails constraining others'
- 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
- There are externalities associated with inequality: It undermines economic performance (see, e.g. Stiglitz, *The Price of Inequality*)

Some coercion can be freeing for everyone

- Cities couldn't function without traffic lights—there would be gridlock; no one would have the freedom to move
 - Traffic lights represent a little coercion—taking turns
 - In doing so, they increase everyone's freedom to move
- The argument is more general: Public goods (like basic research, investments in infrastructure, and education and health) can expand the opportunity sets for all
 - They have to be financed
 - In the case of pure public goods (like knowledge), there are incentives to be free riders
 - Need coercion—forcing people to pay
- 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

Exploitation and freedom

- Un- and under-regulated markets are marked by exploitation, even when there is a high level of competition, but even more so when competition is limited
 - Exploitation of market power and of the vulnerable and imperfectly informed
 - Exploitation further undermines claims of the efficiency of (unfettered) markets
- 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 in extreme cases (monopolist has control over something necessary for life itself)

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
- 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 of mis- and disinformation
 - Who is to judge? In some cases may be easy
 - Assessing “truth” in certain critical cases is essential for functioning of democracies

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

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 are not competitive or efficient (or stable)
- Maximizing shareholder value does not maximize societal well-being
- They 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's view of economics was wrong

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

Neoliberal capitalism may not even be a sustainable institutional arrangement

- It is not environmentally, socially, politically, or economically sustainable
 - Environmental effects are now evident
- With government oversight, competition won't be sustained
- The divides it gives rise to make it politically unsustainable
- The divides it gives rise to weaken trust, and without trust, a market economy can't function
- It encourages individual traits which also undermine trust, and thus undermine economic sustainability
- **Neoliberal capitalism is a system which may devour itself**

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**, with a rich ecology of institutions (including cooperatives and not-for-profits, and government provision of a “public option”) and forms of collective action (unions, civil society, class action suits)
 - Most successful US institutions are not-for-profit universities and research institution—at least until attacked by Trump
 - 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
 - **Other important “collective” roles**
 - **Limiting a variety of forms of exploitation**
 - **Ensuring competition—making markets work like they’re supposed to**
 - **Providing social insurance**
 - **Better risk management enables more risk taking, more innovation**

Checks and balances

- A democratic society needs to **avoid concentrations of power**
 - Need checks and balances within society, not just within government
 - Excessive concentration of economic power gets translated into a concentration of political power—which leads to rules of the government that reinforce and extend economic inequalities
- There may be multiple societal equilibria—an equalitarian equilibrium and one marked with large societal divides
 - Critical (and difficult) question of how one moves out of the latter towards the former—and how one prevents slipping from the “good” equilibrium into the bad

Academic and press freedom are an essential part of our system of checks and balances

- Which is why authoritarian figures like Trump work so hard to undermine both
- Academic freedom: society has created as part of its “control” system institutions with individuals devoted to analyzing how and how well the system is performing, and how to design reforms that might enable it to work better
- Need to have individuals able to freely criticize both system and those who are running it
 - And those criticisms and ideas have to be widely disseminated
 - True press freedom can’t exist if the media is “captured” by an oligarchy (echoing earlier discussion)
- These are all ideas associated with the Enlightenment

Explaining why we have higher standards of living today than 250 years ago and longer life expectancy

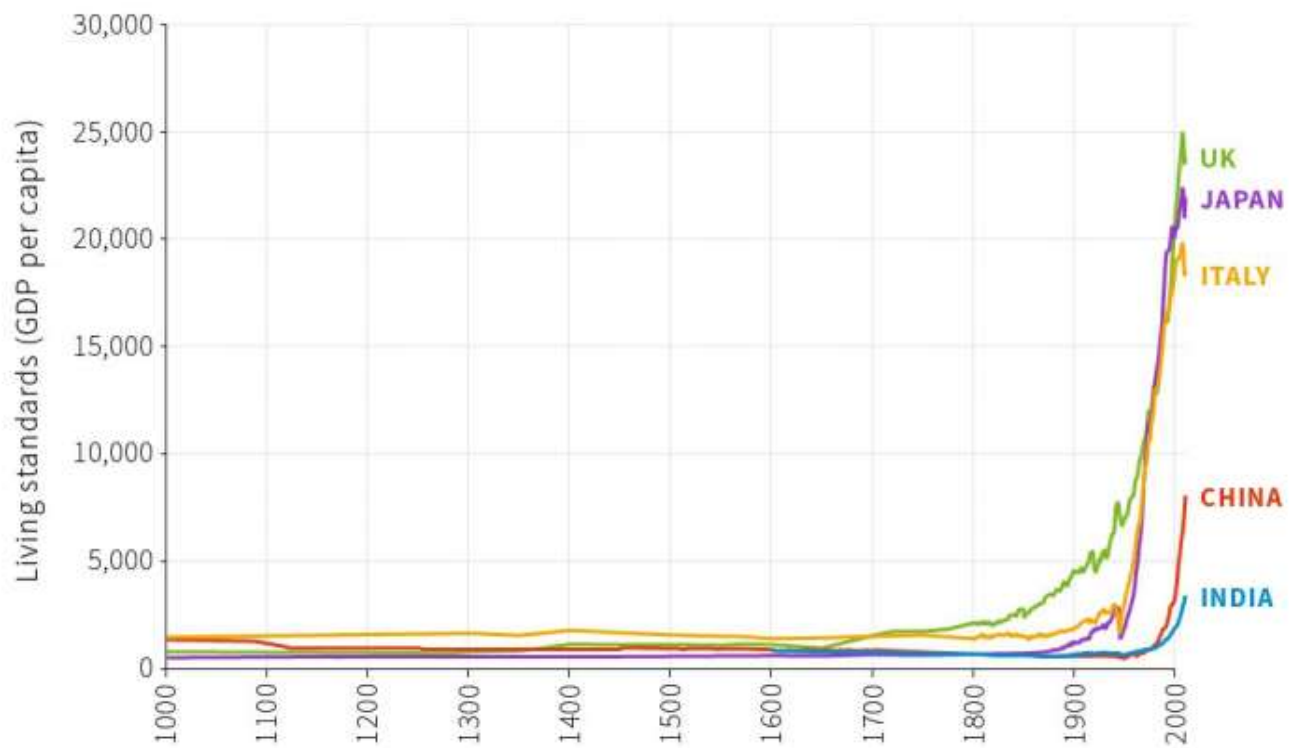
- The transformation to “learning societies” —the change in mindset associated with the Enlightenment—that occurred around 1800 for Western economies, and more recently for those in Asia, appears to have had a far, far greater impact on human wellbeing than improvements in allocative efficiency or resource accumulation.
 - For hundreds of years standards of living had remained essentially unchanged

J.E. Stiglitz and Bruce Greenwald, *Creating a Learning Society: A New Approach to Growth, Development, and Social Progress*, W.W. Norton, 2015

Enlightenment values, responsible for economic progress, were a change in mindset

- Questioning authority
- Recognizing that our understanding of the world could increase and **change was possible—the belief in progress**
- Requiring reassessment of how we know “truth” **and of how we organize society**
- The **scientific method** provided systemic way of figuring out how to improve productivity
 - Getting more outputs from given input
- **Advances in social organization (rule of law, new institutions with new norms)** allowed cooperation among larger numbers of people—increasing the extent of the market and the ability to solve complex problems

Historical living standards



Source: INET

Real wages of London craftsmen, 1200-2000

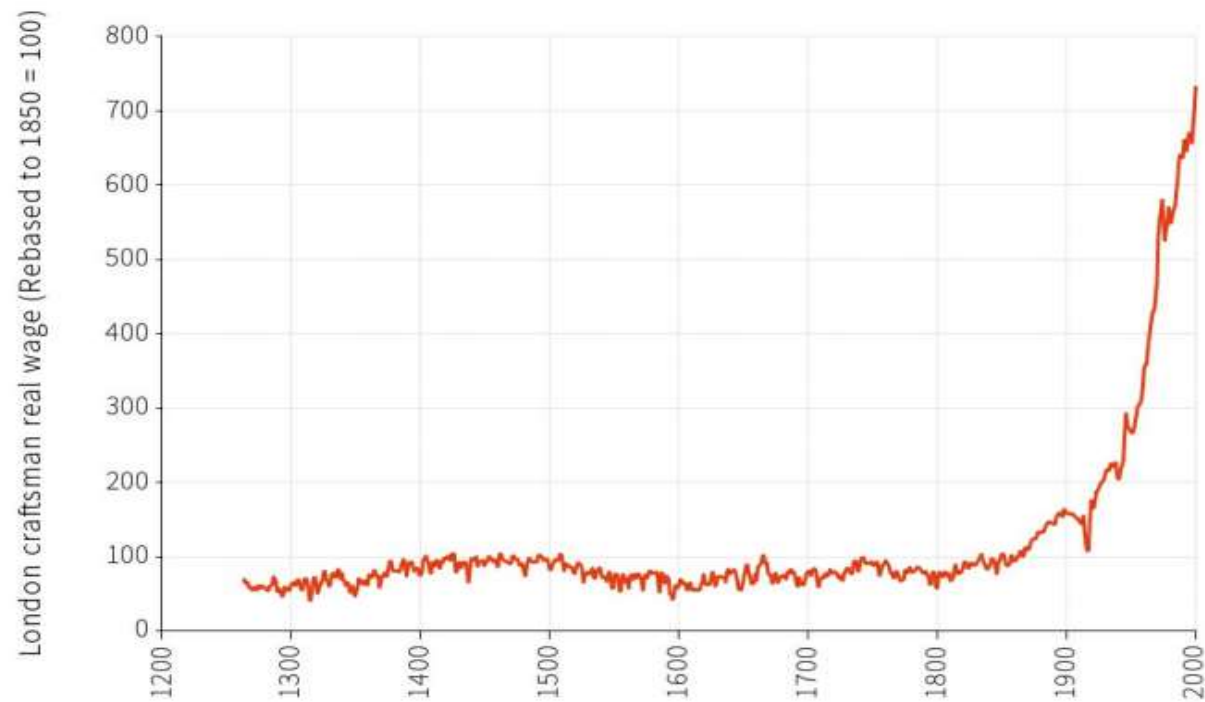
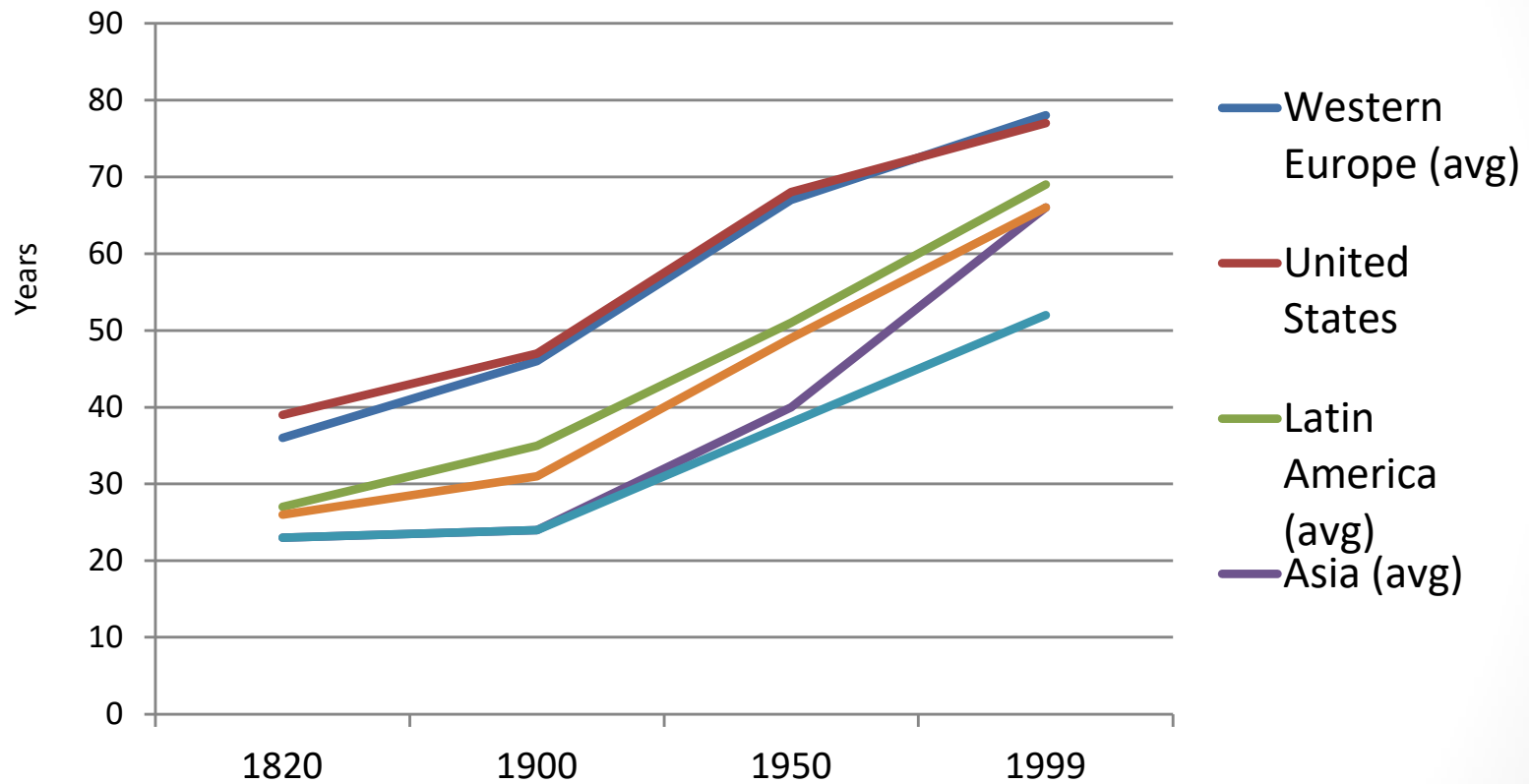


Figure 3. Real wages over seven centuries: craftsman (skilled worker) in London (1264-2001).

Source: INET

Improvements in life expectancy since 1820



Data are estimates from A. Maddison, 2001, "The World Economy: A Millennial Perspective," OECD.

That change in mindset was associated with the creation of liberal democracies

Undemocratic governments have succeeded in closing the knowledge gap

- But can they do this on a sustained basis? Can they be knowledge leaders?
- And typically associated with significant cross-border flows, not just of ideas but of people
- **But liberal democracy with good institutions are not enough—underlying their creation and their sustainability must lie individuals committed to them, underlying beliefs and norms**

Shaping individuals in a different way

- Current economic system shapes individuals—to be greedy, selfish, with limited concerns for others, less empathy and less honest than we might like
 - 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
- Subject of research in “modern” behavioral economics—focusing on endogeneity of preferences (Demeritt, Hoff, and Stiglitz, *The Other Invisible Hand*, forthcoming)

Centrality of liberal education and democratic media

- 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
- More democratic media “frees” us from having our beliefs shaped by and for the interests of the wealthy

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”
- Setting us more firmly *on the road to freedom*