

Economics and the Good Society¹

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It is a great pleasure to be back in Athens, and back at your University, to receive this honorary doctorate.

Around the world, Athens is recognized as the birthplace of democracy, of the idea that individuals have the right and freedom to govern themselves. In the nearly three thousand years since the founding of Athenian democracy, we have made some progress in understanding its complexities and what is required for a successful democracy to function. We have come to realize how fragile our democracies can be. You lost your democracy to a military coup in 1967. Many worry that the US may be on the verge of losing its democracy—with a presidential candidate claiming that he would be a dictator (if only for [a day](#)) and that if he wins this election, “[you don’t have to vote again.](#)” Americans, who have been taught that the American Revolution represented the rebirth of democracy, have come to question this heritage after both Republican presidents of this century took office with a distinct minority of the popular vote, under a Constitution written by rich, white men, many of whom were slave-owners, a Constitution that, while enshrining minority rights with majoritarianism, failed to preserve the voice and rights of the majority.

This evening, I want to focus my attention on the concept of freedom itself. It might seem strange for an economist to have

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chosen such a subject, but economists have long been engaged in debates about freedom and its relationship to the economic system. Most importantly in the 19th century, John Stuart Mill wrote *On Liberty*, and in the middle of the 20th century, Milton Friedman published his books *Free to Choose* (written with his wife Rose) and *Capitalism and Freedom*, and Friedrich Hayek wrote *The Road to Serfdom*. Published in 1944, Hayek was worried that too large a state would result in the loss of freedom and liberty as Keynesian ideas about how to prevent and respond to another Great Depression, and the Scandinavian welfare state, were both gaining traction.

The claim of Hayek and Friedman was that “free markets” and “free enterprise” were the best ways to promote economic wellbeing and individual freedom; that there were moral justifications behind market-driven distribution—the theory of just deserts; and that such unfettered capitalism was essential for maintaining political freedom.

Hayek and Friedman had made important contributions to economic science in their early work, but their lasting fame is because they were great polemicists—their ideas remain influential decades after their passing. Terms like “free markets,” and “free enterprise” were used deliberately to bias the discussion. Who could oppose freedom, and therefore who could oppose free markets?

But each of the claims was suspect, and in some cases the claims were known to be wrong, or at least not generally true, even at the time they were made. 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.

It is clear today, too, that the growth of authoritarian populism is greatest in countries where governments have done too little—for instance in addressing problems of poverty and insecurity—than where governments have done too much.

A central thesis of my recently published book *The Road to Freedom: Economics and the Good Society*, is that it is important to reclaim the “freedom agenda” from Libertarians and those on the Right. I am pleased that Kamala Harris has taken up this challenge. A core message (evident on her website) is: “SAFEGUARD OUR FUNDAMENTAL FREEDOMS.” It goes on to elaborate: “Vice President Harris’ fight for our future is also a fight for freedom. In this election, many fundamental freedoms are at stake: the freedom to make your own decisions about your own body without government interference; the freedom to love who you love openly and with pride; and the freedom that unlocks all the others: the freedom to vote.”

The meaning of freedom

I won’t have time this evening to talk about every aspect of freedom or every interpretation. Like Mills, Friedman, and Hayek, I look at the matter through the lens of an economist. Let me begin with an economist’s definition:

Liberty is about a person’s freedom to act. A person at the point of starvation has no real freedom; he does what he must to

survive. Changes in a person's opportunity set—the set of options that he can undertake—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. Many have focused on how regulations or taxes thus take away an individual's freedom. But this is looking at the matter as if individuals live in isolation. They obviously don't. We live in an increasingly interdependent, complex, urban society.

In such a context, there are inevitably conflicts of freedoms. As the Oxford philosopher Isaiah Berlin put it: "Freedom for the wolves has often meant death to the sheep."

I have put it less poetically: One person's freedom is another's unfreedom.

Economists refer to these situations as giving rise to externalities, and they are pervasive and ubiquitous.

One person's right to carry a gun threatens another person's right to live. And it takes away still another freedom, a freedom emphasized by America's great president, Franklin Delano Roosevelt: freedom from fear. Every day in the US there is a mass murder, many in schools, so every parent worries about whether his kid will be subject to such acts of violence, and school kids have to be trained—from kindergarten on—on what to do if a gunman comes into the school.

The right not to get vaccinated or wear a mask threatens others' right not to get a disease, or even to live.

The right to pollute threatens others' rights to live a healthy life—and again, sometimes even the right to live.

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. In other cases, more dialogue and discussion may be required to figure out the appropriate balance, and the answers may differ across societies and over time.

Thus, for any society to function, there must be regulation. The Ten Commandments were a simple set of regulations—“Thou shall not steal” took away the rights of the thief to the benefit of everyone else. Our more complex society obviously requires more and more complex regulations.

Similar trade-offs are pervasive. One can look at the issue of redistribution through this lens. As I've noted, libertarians and conservatives argue that taxation is a deprivation of liberty—of the right to spend one's money as one pleases. Thus, the claim is that taxation is coercion even when there is some form of representation. Taxation constricts the individual's budget constraint, constraining what he can do, his opportunity set.

But such an analysis ignores the fact that 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'. The benefits from expanding opportunities by providing health and education to the poor, expanding their freedom to act, enabling them to

more nearly live up to their potential, may be far more important than the costs of constraining the opportunity sets of the rich, limiting slightly the size of the yachts that they can purchase.

This is even more so if there are externalities associated with inequality, as I argued in one of my earlier books, *The Price of Inequality*. Inequality not only has bad social and political consequences, but it also undermines economic performance.

So far, I have emphasized that there are trade-offs in freedoms. But there are some important situations where 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—drivers have to take turns; they have to wait until their light is green. This mild coercion increases 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. We might not be here today were it not for the Covid-19 vaccines and especially that based on mRNA. The mRNA platform was developed as part of basic research financed by the government. More broadly, the research on which the vaccine development rested was financed by government, and in some cases the research was undertaken in government-run laboratories. But such public goods must be financed. In the case of pure public goods (like knowledge), there are incentives to be free riders. Thus, coercion is needed to force

people to pay. With such coercion, everyone's opportunity can be expanded—in this sense, the “freedom to act” has increased.

Thus, we have the seeming conundrum that coercion can enhance freedom.

Sometimes government is required to provide coordination, and such coordination involves very little (or no) sustained coercion—with enormous benefits. Consider the problem of which side of the road to drive on. Without coordination it would be a disaster. Once the rules are set, they are easy to sustain. In this particular case, it made no difference which rule one adopted—and different countries have done things differently. But collective action (here taking the form of coordination) is essential.

Exploitation and freedom

Another key role of government, of collective action, is the prevention of exploitation. The Right argued in favor of unfettered markets. Markets take care of themselves, they said. More than six decades of research has shown that this is not true, that as I put it in one of my earlier papers, the reason that the invisible hand (Adam Smith's notion that the pursuit of self-interest would lead, as if by an invisible hand, to the wellbeing of society) is invisible is that it's not there. Markets on their own are not (Pareto) efficient.

In particular, un- and underregulated markets are marked by exploitation, even when there is a high level of competition, but even more so when competition is limited and information is imperfect.

Again, there is a trade-off: The right of corporations to exploit vs. the right of others not to be exploited. The exploitation of market power by monopolists constrains consumers' opportunity sets—and leads, of course, to inefficiencies. There is, I think, a broad consensus that exploitation should be constrained in spite of the loss of “liberty” by the monopolist; that the freedom of the exploiter to exploit is less important than the freedom of the rest of society not to be exploited. This is so both on moral and efficiency grounds. This is particularly evident in extreme cases, such as when a monopolist has control over something necessary for life itself. I have thus suggested that Friedman's book *Free to Choose* might have been better titled *Free to Exploit*.

Mis- and disinformation

I mentioned earlier that in some cases, how society balances freedoms is easy, but in other cases it is more difficult. I now want to discuss a particularly difficult case, which Europe is coming to grips with but which the US has failed to address: the freedom to spew mis- and disinformation and the freedom in particular of the online platforms to disseminate such mis- and disinformation without any sense of responsibility, and without any liability. It's a freedom that is having a pernicious effect on all of our societies. This problem is compounded by the seeming freedom of the platforms to steal intellectual property produced by others, including our traditional media; in the case of Google, this has been shown to contribute substantially to their profits, as it attracts “eyeballs,” which, in turn, attract advertising—with devastating effects on traditional media and their ability to

perform their essential roles in gathering and disseminating news and doing investigative reporting.

These subjects are of particular interest to me because of my work over decades on the economics of information.

Free speech fundamentalists say anything goes; but few societies have gone so far: one can't cry fire in a crowded theatre, and most societies ban child pornography. As technologies change and threats to our society change, we have to rebalance how we make tradeoffs, even in this vital area. We have become aware of a vast array of digital harms—dangers of incitement to riot, to racial hatred, to the wellbeing of children, the list goes on—with no accountability by the big platforms. The EU's Digital Services Act is an important first step, but it has not gone far enough. There are good reasons to worry that these problems will get only worse with AI. I should note that the US Constitution's First Amendment, which guarantees freedom of the press, is silent on the issue of restrictions on virality.

So too, Australia, with its bargaining code, has gone further than most other jurisdictions in holding the digital giants accountable for the information that they take from others. And again, this problem will only get worse, as AI seeks to use information from all available sources, with no or minimal compensation.

If perceptions, beliefs, and preferences can be altered by the media, then society faces an important set of decisions. Who gets to control the media—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, and further constraining the “freedom” (choices) of others?

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

Economy efficiency, sustainability and “free markets”

I noted earlier that unfettered markets are not in general efficient and are invariably marked by exploitation. Friedman and Hayek’s views that capitalism enhanced individual freedom were flawed because their analysis of individual liberty in an interdependent society was flawed; but their understanding of economics was even more flawed. I wanted to elaborate briefly on this theme, because remarkably, in spite of all the research to the contrary, the view that markets on their own are efficient and stable still has a great deal of currency—one can just look at the reception given to the [speech](#) by Argentina’s President Milei at Davos.

Friedman, in his famous *New York Times Magazine* article, contended that firms should maximize shareholder value; doing so would not only enrich shareholders but ensure overall economic efficiency. At the same time, my own research showed the contrary—but my results, published in journals like the *Quarterly Journal of Economics* and *The Journal of Finance*, with all the formal modelling and formal proofs expected of scientific enquiry, didn’t have the influence on the law that Friedman’s

article in the *New York Times Magazine*, even though they've withstood the test of time, while his analysis has not. Of course, those owning the corporations loved Friedman's ideas, and had the power to push it.

People on the Right have underestimated or ignored a host of market failures (externalities, imperfections of information, incomplete markets, etc.)—and today, these are at the center: global warming represents an existential threat; we are an interdependent urban society; and we are a knowledge and innovation economy, and innovation rests on foundations of basic research, which is a public good that has to be publicly provided.

Perhaps an even more important limitation of the neoliberal analysis is that the underlying model of the individual is flawed—assuming as it does well-defined, fixed preferences, a perfectly rational, perfectly informed and perfectly selfish individual. (Regrettably, over time, the market economy has succeeded in making individuals more like such individuals—especially with respect to greed and selfishness—with adverse consequences that I describe below.)

Hayek's evolutionary approach, while somewhat more subtle, is equally flawed. The claim was that the dynamics of markets, the evolutionary process, would lead to better outcomes, a wealthier society. But the claim was simply an assertion, not based on any economic analysis. Indeed, if he had understood evolutionary processes in biology, he would have been far less confident in his belief in the efficiency of these processes. There is no teleology

in evolutionary processes. There is *no* presumption that they result in the overall long-run dynamic efficiency of the economy; and by now, we understand why they often don't work well.

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; and trickledown economics would ensure that benefits would be shared by all. The forty-five-year experiment with neoliberalism (beginning with Reagan and Thatcher) has instead led to lower growth and more inequality, with those at the bottom in many countries seeing real incomes fall. The resulting disillusionment has understandably led to the growth of populism, setting us off *on the road to fascism*. One might say that Hayek and Friedman, these apostles of free markets, have ironically been the ones who have set us off on the road to serfdom.

Neoliberal capitalism may not even be a sustainable institutional arrangement. It is not environmentally, socially, politically, or economically sustainable. We have already discussed the lack of political sustainability. The environmental effects are now evident: we have gone beyond our planetary limitations.

The economic and social divides it gives rise to make it not just politically unsustainable but also economically unsustainable; these divides weaken trust, and without trust, a market economy can't function. Our system of ruthless competition encourages individual traits—like selfishness, greed, and dishonesty—which also undermine trust, and thus undermine economic sustainability. These traits seemed to characterize much of the

banking industry in the runup to the 2008 crisis. Trump is, in so many ways, emblematic of the “character” created by American capitalism and revered by it.

Moreover, without government oversight, competition won’t be sustained.

In short, neoliberal capitalism not only is a system that has failed, even in its own narrow terms of economic performance, it is a system that may devour itself.

Progressive capitalism

The two critical questions are then: What kind of society (economy) is most likely to enhance the “freedoms” of most citizens? And what kind of society (economy) is most likely to sustain political freedom and democracy?

The economic arrangements I refer to as progressive capitalism. I frankly don’t like the label—capital is hardly the central feature. In Europe, I often refer to this as rejuvenated social democracy.

It should be clear that there are alternative ways of organizing society that can do a better job of enhancing freedom. In the limited time I have, I want to draw attention to four features of this alternative.

First, in progressive capitalism there is a better balance between the market and the State (and more broadly, collective action), 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, NGO’s). The most successful US institutions are our not-for-

profit universities and research institutions. Emblematic of for-profit educational institutions is Trump University, which excelled in only one thing, fleecing its students.

As I have already noted, externalities and public goods are especially important in a 21st century economy, with its high level of urbanization and focus on a knowledge and innovation economy.

There are other important “collective” roles: Limiting a variety of forms of exploitation, ensuring competition, and providing social insurance—which, because of its ability to mitigate individual risk, enables more risk taking, and thus more innovation.

As the structure of the economy changes, the importance of and the challenges in maintaining competition have increased. So too, as we’ve moved to a Care Economy, the opportunities for exploitation by for-profit corporations has increased, and so has the need for alternative institutional arrangements and better regulatory structures.

There is an important role for government not only in promoting innovation but in directing it: it cannot be the best use of our scarce intellectual resources to have them focused on building a better advertising engine—which has been the case in the US for the past quarter century.

Secondly, a crucial feature of this rich ecology of decentralized entities is that they can provide checks and balances against each other. All humans are fallible, and all human institutions are fallible. As the old adage puts it, power corrupts, and absolute power corrupts absolutely. We have to limit concentrations of

economic and political power, and that entails not just strong competition laws but also strong distributive policies; inevitably, concentrations of wealth will lead to concentrations of political power, which will reinforce the economic inequities.

Thirdly, the design of the economic system has to be sensitive to how it shapes individuals, and thus society. As I have noted, neoliberal capitalism shaped individuals to be greedy, selfish, with limited concerns for others, individuals with less empathy and who are less honest than we might like. Cooperatives may help shape individuals to be more cooperative and other-regarding. All of this could enhance social cohesion—the opposite of the polarization we have seen, a polarization which has been aided and abetted by social media, whose business model is engagement by enragement. With such other-regarding behavior and greater social cohesion, the need for more intrusive forms of coercion to deal with negative externalities is reduced.

Fourth, progressive capitalism recognizes the centrality of a liberal education and a democratic media. Education, with the better understanding of the way our preferences are shaped and our actions are affected by others that it provides, can be “freeing”—one of the purposes of a liberal arts education.

Similarly, a more democratic and diverse media “frees” us from having our beliefs shaped by and for the interests of the wealthy.

Philosophical challenges

Before concluding, I want to note a difficult philosophical problem that arises as soon as we recognize the endogeneity of preferences: The economists’ standard individualistic welfare

framework breaks down. Which preferences (utilities) are we supposed to be maximizing? A positivist framework, with a focus on Pareto efficiency, has been at the center of normative economic analysis for a century. Discussion of Pareto efficiency enabled economists to avoid interpersonal utility judgments or judgments about what makes for a good society. This made economics a more technocratic subject, though in practice, economists had to go beyond this framework—few policy choices led to Pareto improvements, so some judgments entailing interpersonal judgments had to be made.

Recognizing the 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 it forces us to consider what we mean by a good society: Do we want our children to be selfish, greedy, and dishonest?

Concluding Remarks

This evening, I have highlighted several themes related to a deeper enquiry into freedom.

First, as an economist, an essential part of freedom is the freedom to do—and that includes the freedom to live up to our potential.

Second, in an interdependent society, freedom for some may entail the loss of freedom of others: freedom for the wolves has meant death for the sheep. Liberalization—freedom for the bankers—would have meant death for the economy, had government not intervened; and that intervention required

billions of dollars of taxpayers' money—the crisis reduced the freedom not just of taxpayers, but also of workers and homeowners.

Third, a little coercion can, in a meaningful sense, expand the freedom of all: when we work together, we can do what we cannot do when we act alone, and to avoid the free rider problem, there may need to be some coercion.

Fourth, neoliberal economics, while it expanded the freedom of corporations to exploit others, did not lead to overall prosperity, let alone shared prosperity. Good economic theory had predicted this, even before neoliberalism became fashionable in the era of Reagan and Thatcher. Neoliberalism is a system that is not even sustainable, as it encourages individual traits and market behavior which undermine its very functioning.

Fifth, there are alternatives, namely different versions of what I have called progressive capitalism or a rejuvenated social democracy, that hold the promise of achieving not only better economic performance, but greater shared prosperity and more meaningful freedoms for more individuals.

With greater investments, including in public goods and individuals' capabilities, better management of negative externalities, better advancement of activities with positive 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,” or at least a better society, and setting us more firmly *on the road to freedom*.

Let me thank you once again for the honor which you have bestowed upon me.