The Political Economy of Freedom: A Critique

Is Liberalism is natural? Is it just? Are political and economic liberalism in conflict? Is Liberalism an artifact of the “West?”
Today’s Menu

1. Review
   1. Key concepts of liberalism
   2. Polanyi’s first critique: markets had to be created by the state….they aren’t natural

2. Finishing Polanyi’s critique: Markets had to be created: Fictitious Commodities
   1. What they are and their effects
   2. The double movement

3. Liberal political economy: Markets and Democracy:
   1. Classical Liberal argument: Markets and democracy support each other
   2. An Economic liberal Critique: Democracy hurts Markets
      1. Democracy creates “rent seekers”
      2. Authoritarian governments are better for free markets
   3. A political liberal’s Critique: Markets hurt democracy
      1. Markets create inequality and limit political freedom
      2. Democracy requires state intervention and public ownership

4. Is liberalism bound to Western Culture?
Review: Assumptions of Liberal Theory

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Status</th>
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<tr>
<td>Individual Rationality</td>
<td>+</td>
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<td>Private Property and Property Rights (reduce transaction costs)</td>
<td>+</td>
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<td>Natural Propensity to trade and exchange <em>Spontaneous Markets</em></td>
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Review: Liberal Theory (cont.)

Freedom required to remove barriers to exchange

Voluntary exchange
(no cooperation/collective action needed)

Price Mechanism (information about value + lowers transaction costs)

Competition

Innovation + specialization ➔ division of labor

Comparative Advantage in exchange

Efficiency ➔ Growth ➔ Better life for all
Review: Polanyi’s overall Critique of Liberalism

• Critiques liberal economic theory, especially two core assumptions:
  – 1. Assumption that the market is a uniquely “natural” form of economic organization of society
  – 2. Assumption that human economic behavior is naturally, inevitably motivated by the goal of maximizing self-interest and profits
  – Assumption that markets are self-regulating
  – Argument: markets engulf and destroy society
Review: Polanyi argues that Liberalism is not based on “human nature”

• Polanyi’s critique of Liberalism:
  – The market not “natural” It is a historical creation.
    • Pre-market values did not include greed and “rationality”
    • No private property ownership
    • No money economy
    • No labor markets
Review: He argues that Markets were created by states: a fiction that they arose naturally and are self regulating

• In Europe, the market was created by the state!
  – Strong state needed to lower transaction costs*
  – Needed to create market conditions
    • Need for absolute power
    • Law and order
    • Protection
    • Abolish institutions that inhibited a market economy
    • Create fictitious commodities
Sum: The state creates the Market

Pre-Industrial Revolution
No Market System

- No Markets, Land held in common, Labor was human life, land was nature, no economic growth
- Markets were embedded in society, people were content, not striving for gain

Beginning of Market System

- Deregulation (end of Speenhamland and introduction of poor laws), enclosures
- End of the corn laws

Rise of Absolutist State

Introduction Of Market economy
For Markets to work correctly, Fictitious commodities had to be created.

- **What is a commodity?** Objects produced for sale on the market.
- **Why are land, labor, and money “fictitious commodities?”** Because they are “obviously not commodities….anything that is bought and sold must have been produced for sale, but this is not true with regard to them.”
- **Land** is another name for nature.
- **Labor** is another name for human activity that goes with life itself.
- **Money** is merely a token of purchasing power.
Land Before the Market: The “commons”

Before the Industrial revolution, it referred to a pasture that belonged collectively to a village. Think Planet Earth, Think The Air we breathe, water, climate.

Or a piece of land owned by one person, but over which other people could exercise certain traditional rights, such as allowing their livestock to graze upon it.
Commoditization of Land: Private Property and Enclosures

- Convert or carve up the "commons" into private property, giving the new owner an incentive to enforce its sustainability.
- If commons are privatized, each owner will see to it that his personal plot is not overgrazed.
Effects of Commoditization of Land

• Enclosures increased the market value of land, BUT:
• Also, conversion of formerly common land to pasturage reduced employment, damaged the land through pollution and erosion.
Commoditization of Labor
End of the Old Poor Laws, end of state protection of society

- The full Commodification of Labor
- Poor Laws and Paternalism 1652 – Tudors and the Stuarts (Stewarts)
  Under the Poor Law systems a workhouse was a place where people who were unable to support themselves could go to live and work.
- Speenhamland, 1795 – a set of laws implemented in 1795 to protect people from starvation
  - People paid based on a scale, irrespective of their earnings and job
  - Ended in 1834
  - Critique: Poor relief created new and perverse incentives that led to increasing pauperization.
    - Exponential increases in childbirth and illegitimacy, declining wages and productivity, assaults on public morality and personal responsibility, and the development of a culture of indolence.
- 1834 Poor Law Amendment Act abolishes the “right to live.” People could move into workhouses, but these were so degrading/full of destitute people that many poor families refused, became homeless and starved.
- “If Speenhamland had overworked the values of neighborhood, family, and rural surroundings, now man was detached from home and in, torn from his roots and all meaningful environment”
Speenhamland and current welfare policy in the United States

• Critique of AFDC
• The “perversity thesis: “welfare queens”
• well-intentioned policies that provide assistance to the poor by means of state intervention will inevitably harm recipients by substituting perverse incentives in place of the market mechanisms that teach the poor to work hard and exercise sexual restraint.
• Personal Responsibility and Work Opportunities Reconciliation Act
• ended the long-standing entitlement of poor families to assistance—
Creating fictitious commodities leads to the encroachment of the Market on Life Itself

- land, labor, and money as commodities cause severe hardships for large groups of people
- Market fosters Social Darwinist view of society
- Idea of Market value actually devalues what we value
  - From friendship to networking....
  - From nature to commodity
  - From Love to sex
- Polanyi argues that extreme degrees of deregulation & privatization will always threaten society, provoke social protest
The Double Movement example: People fought back against the Industrial Revolution

People had to fight back or it would have been the destruction of Human Society!
Double Movement Example: Neo-liberalism and Anti-Globalization
Another Double Movement in the second decade of the 21st century?

- Does today’s financial crisis and the reactions to it represent another version of Polanyi’s double movement?
- Are movements for regulation today strong enough to swing the international political economy away from the neo-liberal ideals that have dominated for the past 30 years?
Historical Double Movements and the business cycle

- Great Depression and War 1930-45
- End of Bretton Woods
- Globalization 70s, 80s, 90s, 2000s
- Anti-Globalization Movement
- Rise of NGOs, 70s, 80s, 90s, 2000s
- Socialism
- Welfare state
- European Community
- Bretton Woods—40s, 50s, 60s
- Current Financial Crisis
Sum: Liberal theory and Polanyi’s critique

**Smith, Ricardo, Hayek, Friedman, Olsen, Coase**

1. “natural” Rational (self-interested, profit-seeking) individual +
2. Property (rights) +
3. Natural propensity to trade (exchange) +
4. Freedom (democracy...removal of political and economic barriers to exchange) →
5. Markets (voluntary exchange) →
6. Price mechanism (information about value) →
7. Innovation + specialization (division of labor)
8. Comparative advantage →
9. Efficiency →
10. Growth →
11. Everyone is better off

**Polanyi**

- **No** (natural) rational (self-interested, profit-seeking) individual
- **No** Spontaneous markets
- “Natural” human tendency to preserve humanity, society, and nature
- Therefore: markets had to be created by political power (state) →
- Artificial Commodification of land, labor, capital (creation of property “rights”) → destruction of society (community) →
- Some are better off (market winners), more are worse off (market losers) →
- Movements to protect society from markets
But was Polanyi being overly dramatic? Classical Theories argued for the need for political power

- Recognized the need for state institutions to ensure freedom (democracy) and enforce rules of competition (which include providing social safety nets as well as guaranteeing property rights and anti-trust laws)
A second critique: Tensions in Liberalism. Questioning the link between markets and democracy.
The Link actually makes a lot of sense

• Humans are rational and will therefore create the most rational form of society, economy, and politics
• Rationality fosters the desire for individual freedom
• Free markets lead to economic growth which creates a middle class who demands democracy
Why markets and Democracy are good for each other....

• Market economies have worked better than anything before or after.
• Political economy is about the relationship between wealth and power
• Markets diffuse wealth
• If wealth leads to power, then markets also diffuse power
• Democracy is the best way to organize diffuse power
And Markets create the kind of citizens that democracies need

• Market capitalism fosters virtuous behavior that is placed in the service of self-interest
• And self-interest is the basis of rational social coordination
In fact, Markets create democracy!

- “habits and values of a market economy, when transferred to the political sphere, make for a democracy.”
- Even China has a growing middle class which will press the state for democracy.
- And it will eventually win
And Democracy creates markets!

• Because it diffuses political power.
• Why is that important for the economy?
• Because concentrated power creates a barrier to markets. ---
• Democratic governments provides more constraints, more separation of power than authoritarian govts.
But there might be a contradiction in the market-democracy link.

- Competition—not concentration (monopoly)—is essential to a healthy market—but it
- But free markets create winners and losers, insecurity and unpredictability
- Meaning concentration of wealth in hands of winners—for more profits—who then concentrate power—for more security and predictability,
- Thus undermining democracy
- So economic freedom can undermine political freedom
- And political freedom—when exercised—can undermine economic freedom
And maybe Markets and Democracy are bad for each other.

Do we have to choose between markets and democracy?

Cartoon: Stocks dropped on news that few things are totally predictable in a democratic, capitalistic society...
Some say that Democracy Undermines the market: first reason

The reasoning is that markets require economic competition and a minimal but strong state that ensures competition; but democracies are vulnerable to interest group and populist pressures.
A second critique: Creation of overly powerful social groups

- Democracies create “rent seeking” groups or elected officials who can gain power—democracies can create power centers that won’t nourish markets:

- president, and legislators plunder the state treasury to maintain the support of powerful social groups.

rent-seeking
noun
a search for privilege and personal gain through the political process
So Markets flourish better without democracy!

• In fact, countries that have participated in the market and grown fast over the past 50 years -- or over the past 150 -- haven't shown a greater tendency to become democratic.
And Markets don’t necessarily lead to democracy. Consider Russia....
Or Saudi Arabia....
Others say: Markets actually undermine democracy...because they have to be imposed on people (Polanyi)

• Market reforms create opposition
• So in order to push through market reforms, politicians have to be authoritarian
• the process of democratization will be sacrificed at the expense of market liberalization
• And that sacrifices future democratization
People will protest economic inequality (caused by market liberalization) because it undermines political equality

• The market is going to relentlessly produce inequality of income, and eventually that is going to become incompatible with democracy.

• That is where political leadership and institutions come in to constrain the market.

• And they have to constrain more than just monopoly but

• The more constraints, the less free the market
In fact, markets can destroy democracy!

• when democracy fails to deliver the economic goods, people begin to doubt its value. “Few things seem more difficult and yet few things are more important for sustainable liberty than to separate capitalism and democracy in people’s minds. Otherwise, instead of mutually reinforcing each other, the two spiral into disenchantment.”
In fact, some say that **Democracy requires Public Ownership and Planning**
Some problems with all of the above: contingent nature of the relationship

- Whether democracy and markets fit well together depends on
  - When countries enter the market
  - When they industrialize
  - Where they fit in the international system of power and wealth
  - We will talk about this later in the course
And how we define democracy

- we often conflate liberalism with democracy.
There are “dysfunctional democracies”
And Illiberal democracies

WHAT'S DEMOCRACY?

DEMOCRACY IS THE FREEDOM TO ELECT OUR OWN DICTATORS
2. Culture complicates Liberal Theory

[Image of book cover: Asian Values Western Dreams by Greg Sheridan]
Liberals ignore or universalize Culture
They didn’t reckon with Lee Kwan You

I'm not convinced that one-man, one-vote is the best.

we would have a better system if we gave every man over the age of 40 who has a family two votes because he's likely to be more careful, voting also for his children.
Are liberals wrong about human nature?

• Lee Kwan You: The liberal tradition claimed that human beings had arrived at this perfect state where everybody would be better off if they were allowed to do their own thing and flourish. It has not worked out, and I doubt if it will.

• Certain basics about human nature do not change. **Humans exist only in a social context—community more important than individualism** (agrees with Polanyi)
Community is more important than Freedom in some cultures

• Eastern societies believe that the individual exists in the context of his family. He is not pristine and separate. The family is part of the extended family, and then friends and the wider society.
• there is grave disquiet when we break away from tested norms, and the tested norm is the family unit. It is the building brick of society.
• "too much" democracy and "too many" individual rights destabilize social order.
Xiushen qijia zhiguo pingtianxia.

• Xiushen means look after yourself, cultivate yourself, do everything to make yourself useful;
• Qijia, look after the family;
• Zhiguo, look after your country;
• Pingtianxia, all is peaceful under heaven.
So he advocates another form of political economy combining markets with community

• Don’t people in groups need to create hierarchies of authority in order to cooperate?
• (the collective action problem)
• So Singapore is a market economy with an authoritarian government
But Isn’t freedom more conducive to growth than government control over behavior?

• “A key ingredient of national economic success in the past has been a culture of innovation and experimentation. During their rise to great wealth and power the centers of growth -- Venice, Holland, Britain, the United States -- all had an atmosphere of intellectual freedom in which new ideas, technologies, methods and products could emerge.

• In East Asian countries, however, the government frowns upon an open and free wheeling intellectual climate. Does this create a productivity problem?”
No….says Lee Kwan You

• East Asians, who all share a tradition of strict discipline, respect for the teacher, no talking back to the teacher and rote learning, ---have all been innovative…..