

# Critique of Liberalism Continued: How Free are we ***REALLY?***

Irrationality, Institutions, and the  
Market-Democracy Link

# Today's Menu

- I. Critique of Liberalism continued
  - Polanyi: Summary and Critique
  - The Critique from Behavioral economics: Irrationality
  - The Institutional Economics Critique
    - Lindbloom
    - Williamson
  - Liberal Tensions Critique: Questioning The Market-Democracy Link
    - They are not opposed
    - They are opposed
      - Econ. Liberal argument: Democracy creates too many rent-seekers which bloat the state and constrict market freedom
      - Political Liberal argument: Markets create inequalities in wealth which translate into power inequalities which destroy democracy
        - » Markets → “double movement” → undemocratic repression
        - » Empirical evidence that Markets don't lead to democracy

Society is now embedded in the Market Economy, Market is the enemy of humanity, an alien form of organization



# Sum: Liberal theory and Polanyi's critique

## Smith, Ricardo, Hayek, Friedman, Olsen, Coase

- Price mechanism  
(information about value)  
→
- Innovation + specialization  
(division of labor)  
Comparative advantage  
→  
Efficiency →  
Growth →
- Everyone is better off

## Polanyi

- Devaluation of nature, humanity, and exchange through Artificial Commodification → destruction of society (community) →
- Some are better off (market winners), more are worse off (market losers) →
- Movements to protect society from markets

# Critique?

- Free Market capitalism is resilient, conquering vast new places—even China!
- Real Alternatives no longer beckon
- Was pre-industrial society really so great?
  - They were dependent on the weather!
  - superstition
- Does Polanyi represent the triumph of Romanticism?

# Behavioral Economics: How Free are we really?

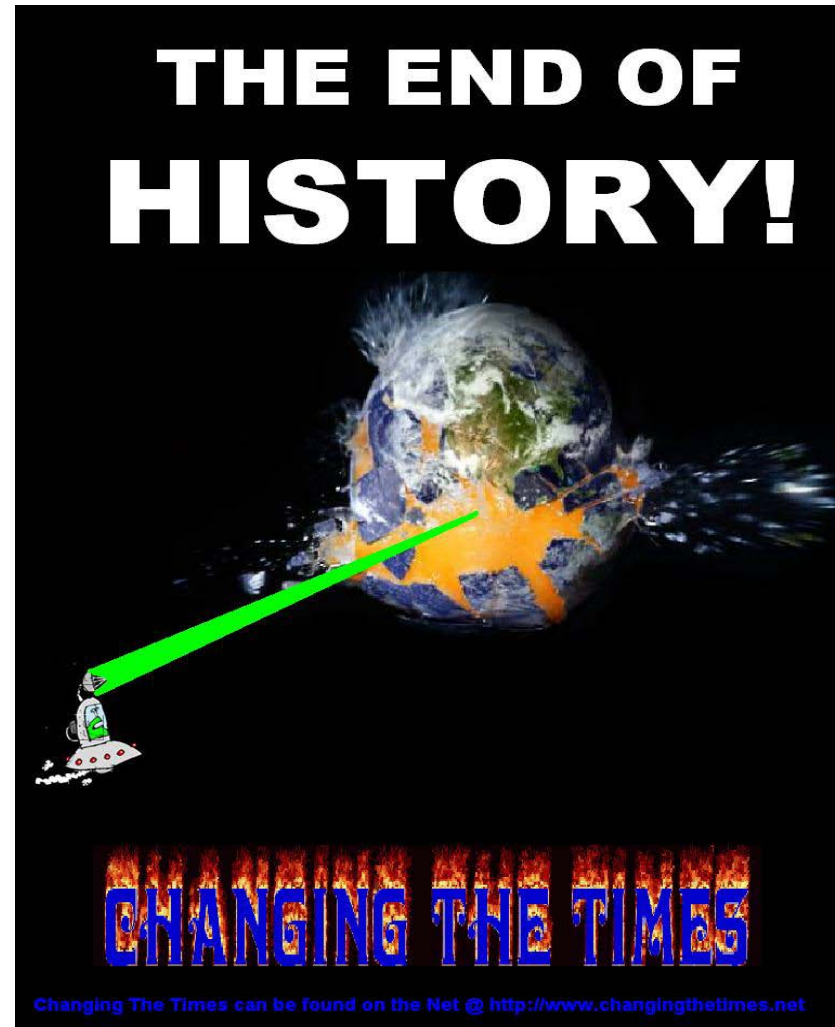
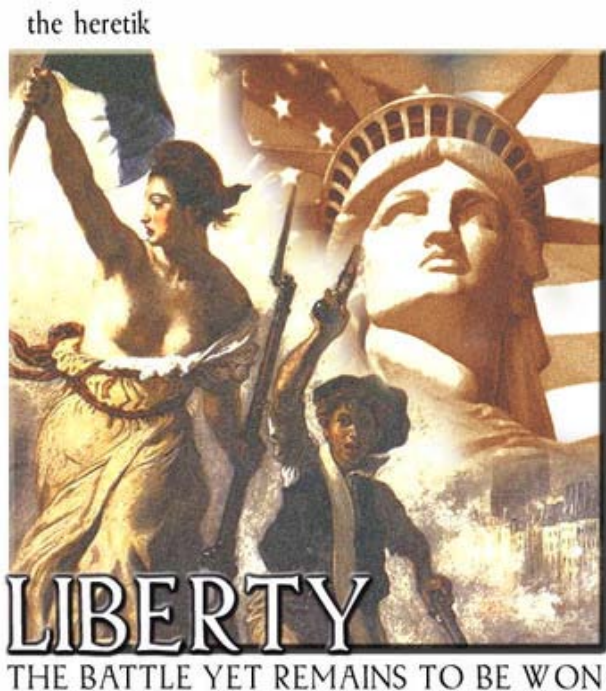
- Game Theory: the **external** strategic environment
- Behavioral Economics: The **Internal** environment in our brain
  - Our rationality is bounded: “The best is the enemy of the good”
  - Guilt, optimism bias, and “fairness” affect our choices

# Institutional Economics: How free are we really?

- questions state-market separation, role of the individual, market competition
- Lindbloom
  - – hierarchies everywhere!
  - State is biggest market participant!
- Williamson
  - Builds on Coase:
    - Transaction costs
    - Asset specificity



: Tensions in Liberalism. Questioning the link between markets and democracy





# The Link actually makes a lot of sense

- If you think that.....Humans are rational and will therefore create the most rational form of society, economy, and politics
- If you think that Rationality fosters the desire for individual freedom
- If you think that.....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

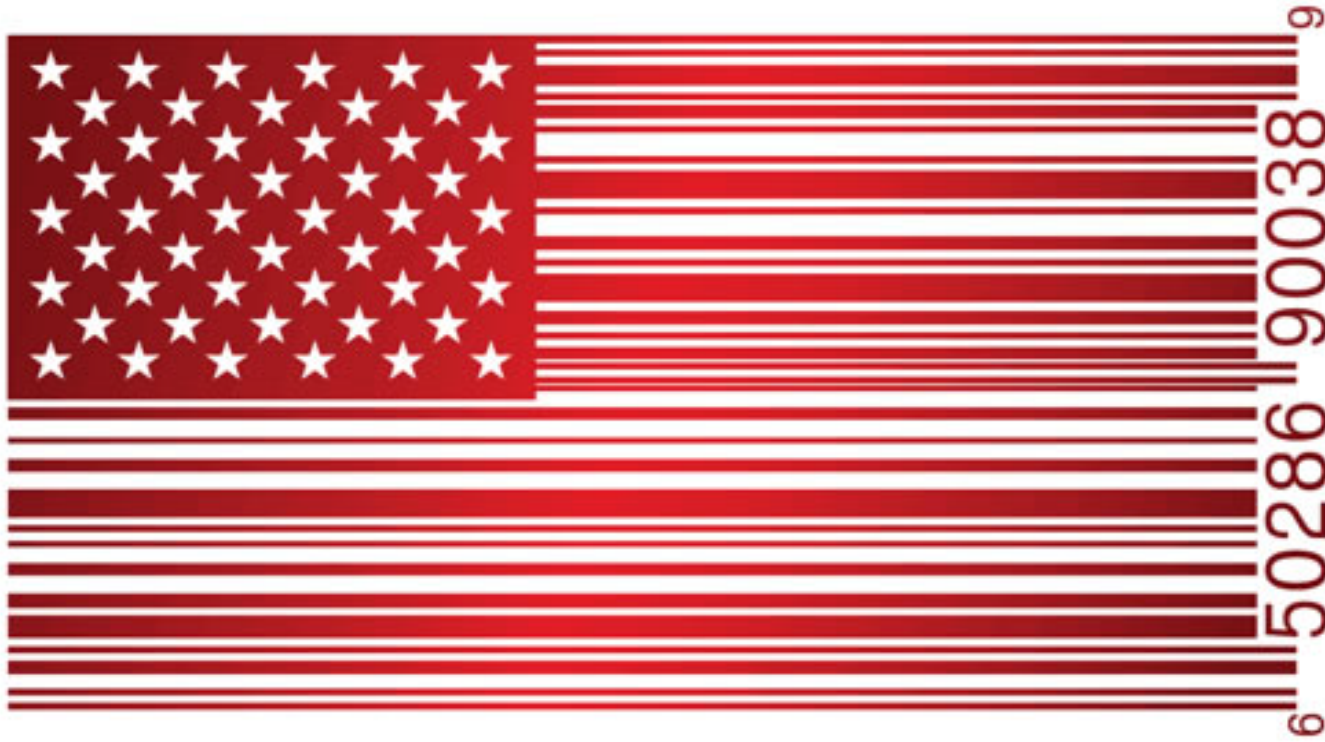
# In fact, Markets create democracy!

- “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.



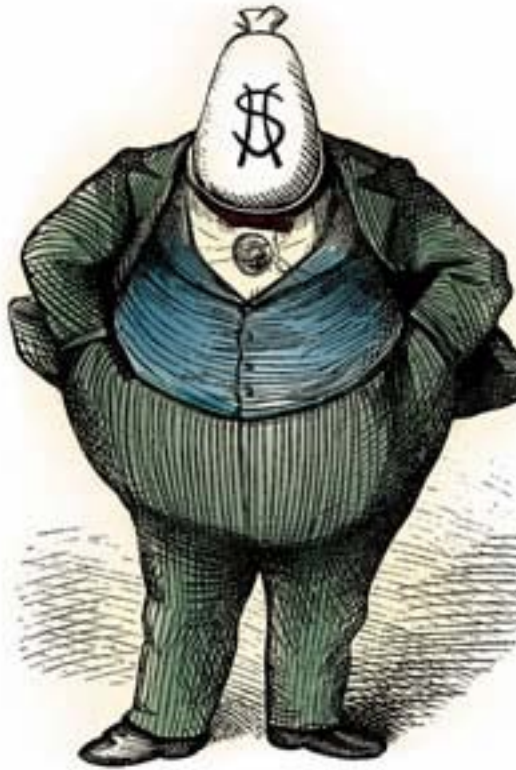
# Economic liberals sometimes argue that Democracy Undermines the market:



*Pundits like Thomas Frank deplore the role of interest-group lobbying, but aren't we all part of some interest group or other?*



Political Liberal argument: Markets create inequalities in wealth which translate into power inequalities which destroy democracy



THE SUPREME COURT OKS ELECTION SPENDING BY CORPORATIONS





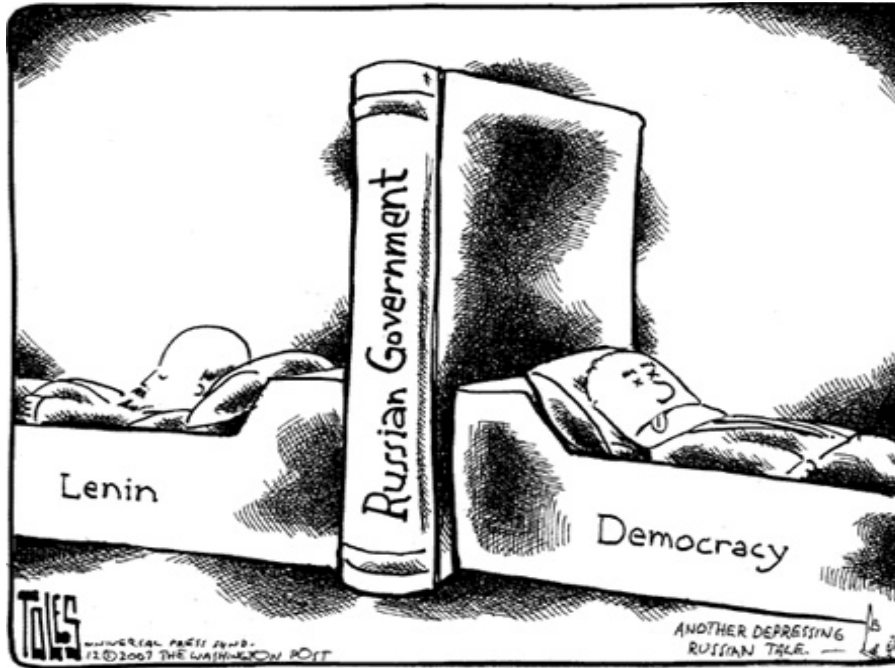
Also....Double movement is inevitable: People will protest economic inequality (caused by market liberalization) because it undermines political equality



# Protest leads to repression



# Empirical evidence that Markets don't lead to democracy



# Egypt





# Not only do Markets NOT create democracy.....

- They can actually destroy Democracy!



The Market dominated by  
Large corporations

Democracy

In fact, some say that **Democracy requires Public Ownership and Planning**



Some problems with all of the above:



contingent nature of the relationship

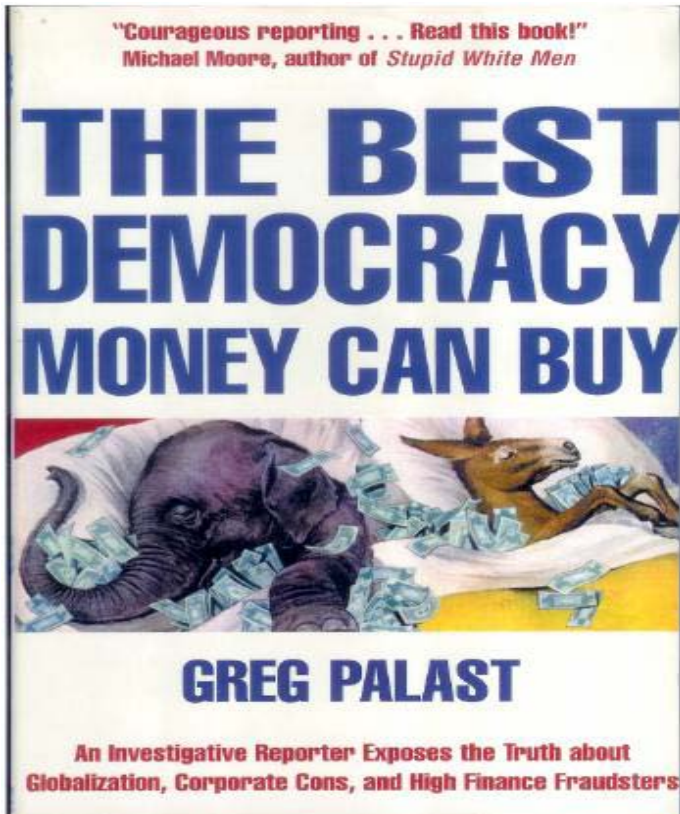
- Whether democracy and markets fit well together depends on
  - When countries enter the market
  - When they industrialize
  - Where they fit in the international system of power and wealth
  - We will talk about this later in the course



# And how we define democracy

- we often conflate liberalism with democracy.

## Dysfunctional Democracy



## Illiberal Democracy





What happens to the political economy of freedom in all of this?

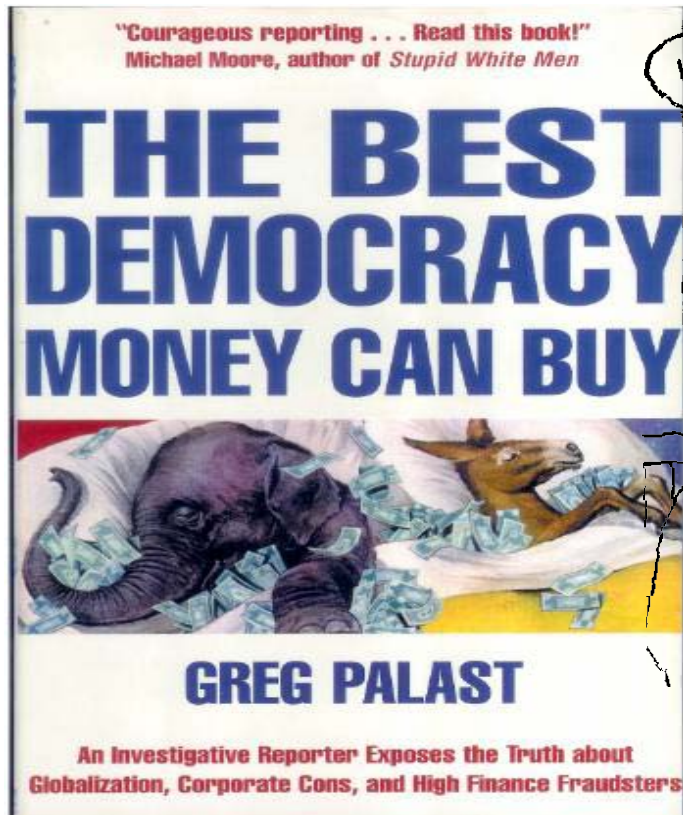




# And how we define democracy

**Dysfunctional Democracy**

**Illiberal Democracy**





# What happens to the political economy of freedom in all of this?

