

POLITICAL ECONOMY



A Comparative Approach

THIRD EDITION

Barry Clark

Political Economy

A COMPARATIVE APPROACH

Third Edition

Barry Clark



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Introduction

Political economy was the original social science. Theorists such as Adam Smith, John Stuart Mill, and Karl Marx developed broad visions of the social system. Not until the latter half of the 19th century did political economy splinter into economics, political science, sociology, social history, social psychology, and social philosophy. The motives for this reorientation were mixed. By partitioning the study of human behavior and society into narrower subdisciplines, social scientists hoped to emulate the analytical power and precision of the natural sciences. However, ideological motives also played a role in the disintegration of political economy. The all-encompassing visions of Smith, Mill, and Marx revealed conflict and tension in society. As political resistance to free markets mounted in the mid-19th century, social scientists hoped to resolve divisive political issues by adhering to logic and factual data to establish a body of knowledge from which public policy could be derived.

Proponents of each of the new social sciences recognized the importance of defining the scope and method of their discipline to establish clearly demarcated boundaries. As the most immediate heir to the legacy of political economy, economics held the greatest potential for emulating natural science because its scope was confined to behaviors most amenable to observation and measurement. The political, social, cultural, historical, and psychological dimensions of human existence were relegated to other disciplines, while economists focused on the individual pursuit of material well-being in the market. The assumption of individual rationality and the use of money as a yardstick for measuring cause and effect enabled economists to construct an impressive body of theory.

Yet, modern economics often elicits skepticism from the general public and from other social scientists. Criticism is directed toward its simplistic assumptions about human behavior, its focus on material and pecuniary interests, its blindness to social relationships, and its esoteric jargon, graphs, and mathematics. Simultaneously, many social scientists tacitly proclaim their admiration of economics as they increasingly borrow concepts, theories, and methods of analysis from the so-called dismal science.

These conflicting attitudes are evident even among economists. On one hand, economics has been labeled the “queen of the social sciences,” and economists have extended their scope of analysis to include issues ranging from government and law to marriage and family life. Yet, underlying this hubris is a caldron of internal dissension. In addition to the expected attacks by heterodox economists, various Nobel Prize winners and respected scholars have expressed qualms about the direction in which modern economics is moving. The focus on mathematics and theoretical rigor, they charge, has rendered much of contemporary economics irrelevant to real-world issues, as revealed by the fact that most of the economics profession failed to foresee the financial collapse of 2008 and the ensuing Great Recession. Despite the increasing elegance of economists’ models and statistical techniques, consensus on how to resolve key social issues remains as elusive as ever. A question arises, how can a discipline in such internal disarray merit emulation by other social scientists?

The answer to this paradox lies in the allure of science. Scientific analysis carries tremendous weight in settling intellectual disputes and formulating public policy. In the social sciences, the quality of scholarship is often judged by its resemblance to the physical sciences, and no other social science has been able to match the rigor and elegance of economic theory. Economists have been successful in large part because their simplistic assumptions and narrow focus permit them to borrow mathematical techniques from the physical sciences.

Historians, political scientists, sociologists, and psychologists have been unable to achieve a single scientific paradigm within their respective disciplines. Economists, however, formed such a consensus from the 1950s to the early 1970s, and their advocacy of Keynesian policies propelled them into positions of influence at the highest levels of government. Yet, the breakdown of the Keynesian consensus during the 1970s and economists’

inability to converge on a new paradigm have diminished the scientific status of economics even as other social scientists increasingly rely on its reputed scientific models and methods.

The quest for a science of economics has not been futile. The sophistication with which empirical data are gathered and analyzed, the construction of elaborate macroeconomic models, and the application of microeconomic theory to decision making have all been impressive. Yet, the public image of economics remains clouded. If economists are indeed scientists, then citizens expect the same expertise and objectivity exhibited by engineers or medical professionals. When economists pronounce widely divergent assessments, forecasts, and policy prescriptions, public reaction ranges from skepticism to disdain. However, economists disagree not because they are incompetent but because they are humans who embody the conflicting values present in modern societies.

The claim that value judgments underlie economics does not necessarily imply that economists consciously seek to advance their personal visions of the good society. For the most part, economists are committed to scientific research in which the facts are permitted to speak for themselves. However, values enter into economics even before research commences. Values affect the choice of issues to be investigated, the theoretical concepts to be used, and the selection of variables to be measured. Although the scientific method of controlled experimentation is designed to keep values out of research, this method has limited applicability in economics, where the laboratory is human society with its complex interaction of innumerable and often unmeasurable variables.

Economists may deny or suppress ideological disputes within their profession for several reasons. First, the reasoning and conclusions of economists lose the aura of scientific authority if they reflect the same unresolved value conflicts confronting all citizens. Most economists view themselves as social scientists seeking to objectively analyze and improve the workings of the economy. Any admission of value commitments might undermine their status as experts possessing higher forms of knowledge.

Second, economic education is transformed when alternative values are introduced into the classroom. The principles and applications of microeconomics and macroeconomics that now occupy a substantial portion of the curriculum can no longer be treated as the whole of economic

wisdom. Students face the challenge of grasping several competing perspectives from which to understand the economy, and professors can no longer rely on their own mastery of a single theoretical approach if students are to be fully exposed to the breadth of economic thought.

Finally, many economists suppress the ideological dimensions of their discipline because they believe that ideological debate can have no resolution. Without scientific appeals to objective evidence, disagreements may degenerate into open conflict. If economics were perceived as merely sophisticated ideology, authoritative decisions by policy makers could be replaced by chaotic struggles for power among competing interests.

Despite these concerns, maintaining the myth of value-free economics poses corresponding dangers. First, economics embodies ethical judgments that would be controversial if made explicit. When these judgments are introduced into policy under the guise of science, one set of values prevails without public debate, violating the principles of a democratic society.

Second, in the realm of economic education, students may gain impressive technical sophistication while remaining naive about the values underlying their knowledge and skills. Lacking this awareness, students believe they have acquired a genuinely scientific technique for analyzing social issues and making policy recommendations. Those students who become professional economists or policy analysts may be baffled when their scientific prescriptions are regarded by others as simply one viewpoint among many.

Third, the effort to minimize public dissent by maintaining the scientific status of economists' expertise reflects a low opinion of citizen participation in democratic societies. By promoting one set of values and portraying other values as merely "special interests," economists narrow the scope for popular input into political decision making. Citizens biased by personal interests are portrayed as incapable of making responsible choices in political matters. However, by sealing important decisions from democratic input, policy makers offer little incentive for citizens to develop knowledge and to engage in public dialogues concerning competing visions of the good society. Moreover, scientific analysis of social issues contains an inherent bias. Policy makers relying on scientific methods inevitably focus on observable and quantifiable aspects of an issue while de-

emphasizing or ignoring intangible or ethical considerations. The method of science tends to limit the scope of analysis to that which can be measured.

This text provides a balance to the currently dominant focus on scientific technique in economics education. Integrating economic analysis with material from history, political theory, sociology, psychology, and ethics reveals the underlying value commitments fueling debates over public policy. Social science cannot be value free, but the values underlying various theories and techniques can at least be made evident and open to discussion.

The purpose of textbooks is to present a body of knowledge nearly universally accepted within a particular academic discipline. In the case of political economy, however, even the most basic terms and principles are subject to debate. The variety of perspectives in political economy dictates a comparative approach to the subject. In this text, four perspectives—Classical Liberal, Radical, Conservative, and Modern Liberal—are covered. Political economy is introduced in the first two chapters; the next four chapters are devoted to the theorists and ideas associated with each of the four perspectives. [Chapters 7](#) through [15](#) cover major issues in modern political economy and, for each issue, present the analyses and policies offered by each perspective. Finally, [Chapter 16](#) examines the roles of science and ideology in political economy.

The contending perspectives struggling for dominance in political economy represent dramatically different visions of the good society. Debates over economic and political issues are ultimately based on these visions, and citizens should be aware of and consider the value commitments underlying alternative policies before choosing among them.

PART I

POLITICAL ECONOMY: AN OVERVIEW

Chapter 1

Politics, Economics, and Political Economy

In all the political systems of the world, much of politics is economics, and most of economics is politics.

Charles Lindblom

Economics does not usefully exist apart from politics.

John Kenneth Galbraith

There is no such thing as a purely economic issue.

Milton Friedman

POLITICS AND ECONOMICS

As a young student of economics, I was frequently asked two questions. I could easily deflect the question about where the stock market was headed by replying that I was majoring in economics, not finance. But when asked about the meaning of economics, I simply reverted to the textbook definition—the study of the efficient allocation of scarce resources among competing ends. With eyes glazing over, the persistent questioner might then ask about the meaning of the term *allocation*. I would again rely on my textbook knowledge, explaining that resource allocation resolves the three

basic economic questions—what goods shall be produced, how are they produced, and for whom are they produced?

Imagine my surprise when I stumbled across a book in the university library titled *Politics—Who Gets What, When, How*.¹ If politics and economics were both concerned with resource allocation, then where was the dividing line between the two social sciences? Not until graduate school did I realize that politics and economics are so intertwined as to preclude a full understanding of one without the other. At that time, my conclusion was not shared by many economists and political scientists who had a professional stake in clearly demarcating and defending their areas of expertise. Even today, an introductory text in economics has virtually no overlap with an introductory text in political science.

Politics and economics were not always so sharply segregated. Beginning in the 17th century, writers used the term *political economy* to describe efforts to understand the relationship between commerce and government. At that time, most European governments were actively involved in promoting economic development through tariffs, regulations, subsidies, and even government-owned enterprises. No person seeking to understand this “mercantilist” system would have conceived of separate analyses of politics and economics because commercial activity was firmly embedded in a web of political and cultural constraints and supports.

By the latter part of the 18th century, however, the expansion of commerce created a dramatic shift in the balance of political power, as merchants and manufacturers successfully challenged government policies restraining the pursuit of wealth. Their efforts gained intellectual legitimacy with the appearance of Adam Smith’s book *The Wealth of Nations* in 1776. Smith argued that government intervention was impeding economic growth and that competition in a free market would generate greater prosperity than could ever be attained through government management of commerce.

Adam Smith (1723–1790) was among the first theorists to perceive the contours of an emerging new society in which the market was becoming disembedded from previous political and cultural constraints. For the first time in human history, it was now possible to conceive of an economy distinct from the rest of society. Smith and subsequent “classical” political economists devoted themselves to analyzing this new capitalist system in

which the individual pursuit of self-interest was a more powerful force in shaping society than the dictates of monarchs, aristocrats, and religious leaders. They searched for an internal logic to the operation of free markets that, once understood, would reveal natural laws (e.g., the laws of supply and demand, the law of diminishing returns, and the iron law of wages) that directed economic activity just as surely as the law of gravity affected physical objects. Since these natural laws governing the economy were believed to be constant and immutable, any attempts by government to impede their operation would be futile at best and more often counterproductive. With some minor reservations, the classical political economists concluded that markets operate best when left free of government regulation except for a legal system to define and protect property rights.

Yet, within half a century, the consequences of free markets were generating intense political opposition. In much of Western Europe and particularly England, workers found themselves toiling for up to 16 hours per day for subsistence wages. Women and children worked alongside men in dangerous, unhealthy factories. Tenant farmers were evicted from land to make way for large-scale agriculture. Clergymen attributed moral decline and dehumanization to the uprooting of people from their traditional ways of life. Many of the skills of artisans and craftsmen were rendered obsolete as production processes were reduced to routine motions easily performed by any worker. Cities were polluted and filled with slums and beggars, some of whom had been maimed by industrial accidents. Growing social tensions and class conflict manifested themselves in riots, strikes, crime, and demands for the right to vote.

By the mid-19th century, the discontent with capitalism led social reformers to initiate efforts to regain some political control over commercial activity. Economic anthropologist Karl Polanyi (1886–1964) described a “double movement,” in which the initial separation of the market from political constraints was followed by a backlash aimed at restoring the primacy of politics over the market.² Governments enacted new laws to address issues such as child labor, length of the workday, occupational health and safety, pollution, education, and product safety.

Politics and economics were once again becoming more obviously entwined, but some of the most influential political economists of that era remained committed to the notion that the economy could be understood as an arena of human activity separate from politics and culture. Beginning in 1871, they developed mathematical models and theoretical arguments aimed at a more sophisticated demonstration of Adam Smith's intuition that free markets yield optimal results for society as a whole.

To reinforce their separation of politics and economics, these "neoclassical" theorists rejected the term *political economy* in favor of the simpler label *economics*. The field of economics would focus exclusively on the operation of markets, leaving analysis of the remainder of society to political scientists, sociologists, and anthropologists. To ensure that political and cultural elements would not intrude on the field of economics, neoclassical economists refused to consider some of the most significant determinants of market outcomes. They assumed individual preferences to be "given," thereby ignoring the socialization process shaping human desires. Technology was also a "given," so economists need not consider the effects of culture and public policy on the development of technology. Another "given" was the pattern of ownership of productive resources, allowing economists to disregard the historical role of power and coercion in the acquisition of property rights. Neoclassical economists reduced individual behavior to rational calculations of self-interest, thereby eliminating all other human motivations and goals. Finally, to exclude any consideration of power relationships between individuals or groups, they assumed that this isolated market was perfectly competitive. With many small buyers and sellers, no individual consumer or producer had any control over prices, and all participants were equally powerless in the face of competitive market forces.

In effect, neoclassical economists artificially separated politics and economics by assuming away all the political, social, cultural, and psychological factors affecting economic activity. By making highly unrealistic assumptions, they created an imaginary free market and a fictitious *homo economicus* (economic man), who made rational choices based purely on calculations of personal costs and benefits. Having eliminated the political, social, and cultural dimensions of human existence, economists were able to construct impressive theoretical models bearing

remarkable similarity to 19th-century physics. These models demonstrated that the actions of rational persons in free markets would lead to a stable economy with full employment and maximum value of output.

Mainstream economic theory continued to uphold the partition between politics and economics for much of the 20th century. From that perspective, economics and politics were separated along three dimensions—(1) the primary actor or decision-making unit, (2) the goal being pursued, and (3) the institutional arena within which decisions are made. Economics dealt with the choices of individual consumers and producers pursuing prosperity (i.e., higher income and wealth) through the market, while politics consisted of decisions by groups ranging from local communities to nations aimed at promoting justice (i.e., defining and protecting property, civil, and human rights) through government. However, this proposed clear distinction between economics and politics cannot withstand closer scrutiny of each of these three dimensions.

Primary Actors

One way to distinguish between economics and politics is to focus on who makes decisions—individuals make economic choices, whereas political choices are the result of collective decision making by groups. This distinction is based on the origins of the terms “economics” and “politics.” Economics derives from the Greek words *oikos*, meaning household, and *nomos*, meaning principle or law. As the principles of household management, economics deals with efforts by individuals to maximize attainment of their private goals using whatever resources they own. Economizing behavior can be directed toward any goal and practiced in any institutional arena. Reflecting this approach, economics is sometimes defined as the science of rational choice to use scarce means to maximize the achievement of specified ends.

Politics, in contrast, derives from the Greek word *polis*, meaning community or society. According to Aristotle, the public life of the *polis* is the arena within which true freedom and human development occur. Although economic activities are essential to human survival, they fail to engage the uniquely human capacities for cooperation and collective decision making based on reasoned argument, dialogue, persuasion, and

compromise. Political decisions are made by groups or representatives of groups and, once made, are binding on all members of the group.

The attempt to distinguish between economics and politics by reference to the primary actor is problematic for two reasons. First, most individuals function as members of groups ranging from families to communities, corporations, and nations. Unlike Robinson Crusoe marooned on a desert island, their decisions are based not only on their private interests but also on the collective interests of their groups. The purpose of morality is to provide individuals with ethical guidelines for balancing self-interest with the collective interest. To be a good parent, good neighbor, good employee, or good citizen, individuals need to demonstrate a commitment to the well-being of the groups to which they belong. Their behavior could be interpreted as economic by arguing that they have simply incorporated the well-being of others into their private calculations of self-interest. Alternatively, their actions may be considered political insofar as they sometimes forego self-interest to promote the collective interests of the group.

Second, the boundary separating the private sphere of economic activity and the public sphere of politics is porous. On one hand, the collective choices of democratic nations reflect the aggregation of private individual preferences as registered through voting and poll-taking. Moreover, individuals and corporations are able to influence public choices through lobbying, campaign contributions, and control over the selection of candidates for public office.

Conversely, the private interests of individuals are shaped by the quality of public life. Humans form their identities, meanings, and purposes within a social context. Private individual preferences are not entirely private; they are also learned through social interaction within groups. Given this interaction between public and private spheres, the distinction between individual and group as primary actors is not fully sustainable.

Primary Goals

The distinction between economics and politics based on their respective goals fails to recognize that prosperity and justice are inextricably linked and potentially mutually reinforcing. A prosperous society is more likely to

be perceived as a just society because the range of individual choice and opportunity is broadened. Conversely, a just society fosters prosperity by providing equal opportunity, fair rewards, and the security of individual rights to motivate production and accumulation of wealth.

Governments seek to promote prosperity as well as justice. In fact, governments occasionally violate individual rights to achieve greater prosperity by invoking the principle of eminent domain to use land for public purposes. Similarly, markets are associated with justice as well as prosperity in the sense that rewards are linked to productivity rather than traits such as race, religion, or ethnicity. The history of economic thought is replete with debates either confirming or challenging the justice of market-determined distributions of income and wealth. In summary, both economics and politics are concerned with promoting human well-being by maintaining prosperity and justice.

Institutional Arenas

Perhaps the most common distinction between politics and economics situates economics within the market and politics within government. From this perspective, exchanges of commodities and money in the market constitute economic activity, while elections, campaigns, and lawmaking occur in the political arena. Although both politics and economics may be concerned with the allocation of resources, government has the power to make an “authoritative allocation” binding on all citizens, while market allocation is accomplished through the price system’s ability to coordinate the choices by individuals to buy or sell particular commodities.³ However, this distinction is not sustainable because government takes on characteristics of a market when mutually beneficial exchanges occur between politicians and self-interested persons or groups. For example, politicians provide particular programs or laws in exchange for votes or campaign contributions. Indeed, with the possible exception of establishing a constitution, government activity can be viewed as a series of exchanges in a political market.

Conversely, the power to command is not confined to government, and the market, therefore, is not devoid of politics. A significant amount of market activity is pursued by large groups of people working for

corporations. The organization of the modern corporation is typically a hierarchical power structure, creating an “island of command in a market sea.”⁴ Corporate executives have the power to formulate goals and rules binding on all employees. Just as governments punish those who violate the law, employers rely on sanctions such as dismissal or demotion to maintain control over workers. To the extent that corporations are successful in suppressing competition, they gain market power (i.e., the ability to control the prices of their products). In addition, many market activities have public consequences (e.g., pollution and plant closings) and therefore become political issues of concern to the nation as a whole. Finally, the more unequal the distribution of income and wealth generated by the market, the greater the power of employers to command the obedience of employees. Based on these observations, sole reliance on the separate institutional arenas of market and government does not provide an adequate basis for differentiating between politics and economics.

Politics and economics cannot be clearly distinguished; these terms simply provide two perspectives on the process of coordinating human interaction to provide society with goods and services. Both are concerned with organizing human activity, marshaling resources, resolving conflict, allocating burdens and benefits, and providing for the satisfaction of human wants and needs. However, politics and economics are not the same; although individual/group, prosperity/justice, and market/government may be interrelated, they are not identical. The separation of economics and political science as academic disciplines serves the purpose of advancing knowledge through specialization of scholarly activity. Yet, despite their important contributions, each discipline needs the other to develop a more robust and comprehensive understanding of human affairs. Fortunately, in recent decades, political economy has once again gained a legitimate place in both academic research and the curriculum.

THE REVIVAL OF POLITICAL ECONOMY

Political economy never disappeared despite the efforts by neoclassical economists to exclude politics from economics. Indeed, the argument can be made that all economic theory contains a political element.⁵ The neoclassical effort to separate politics from economics was dictated by the desire to demonstrate that free markets yield an optimal allocation of resources. The implication is that government should not interfere with the market, but to suggest that laissez-faire is the appropriate role for government is just as much a political stance as is the claim that government should actively intervene in the economy.

Although neoclassical economics continues to dominate the mainstream of economic theory, its influence has declined substantially. It was challenged in the 19th century by historical economics in Germany, socialist economics in France, and institutional economics in the United States. In the 20th century, the Russian Revolution and the Great Depression led to a resurgence of interest in Marxian economics. Keynesian economics explicitly recognized a significant role for active government policies in maintaining a healthy market economy. In contrast, a school of thought known as Austrian economics rejected the neoclassical assumptions of rational decision makers and perfectly competitive markets, but defended free markets for their ability to stimulate innovation and growth. Finally, economists working in Latin America, Asia, Africa, and the Middle East proposed theories of economic development that challenged the neoclassical focus on free markets.

Beginning in the 1960s, a resurgence of political economy developed along three broad paths. The first applies neoclassical economic theory to understand political and cultural institutions. “Public choice theory” assumes that politicians, bureaucrats, and voters are rational maximizers of self-interest and views the political process as a market in which these individuals engage in mutually beneficial exchanges. A related but more recent approach called “new institutional economics” explains political and cultural institutions as arising from the rational, self-interested choices of individuals formulating rules to coordinate their activities more efficiently.⁶

In sharp contrast, theorists following a second path portray the economy as a political process in which the formation of individual preferences, the development of technology, the pattern of resource ownership, and the

structure of markets are all determined by social and political processes in which power differentials determine the outcomes. Power arises from unequal holdings of assets, differences in information, unequal access to government, and suppression of competition. Included in this second path are post-Keynesian economics, social economics, and post-Marxian theory. These varieties of political economy challenging the dominance of neoclassical economics are referred to collectively as “heterodox economics.”⁷

According to a third form of contemporary political economy, economic and political problems are symptoms of cultural and moral decline. From this perspective, the neoclassical assumption of autonomous individuals maximizing their self-interest is merely a description of the disintegration of traditional institutions such as families, churches, neighborhoods, and communities. Without these “mediating structures” to restrain self-interest and harmonize social relations, politics degenerates into a clash of private interests and the economy deteriorates.⁸

The presence of so many schools of thought within modern political economy attests to the absence of a dominant paradigm guiding research into the interaction between government and the market. As the foregoing survey suggests, the very definitions of politics and economics are contested, and the boundary separating them is a matter of ideological dispute. However, underlying the various approaches is a consensus that the interdependence between politics and economics dictates a more holistic method of analysis, encompassing the broad matrix of economic, political, and cultural institutions through which humans coordinate their interaction.

Both the market and government are sufficiently flawed institutions to require a balancing of political and economic processes to sustain a healthy society. In a positive sense, each institution serves to complement weaknesses of the other. However, the market and government also generate powerful forces reverberating throughout society with potentially damaging consequences. Since the market and government interact with each other, efforts to analyze them separately will yield only partial, and therefore distorted, understandings of the social system.

The complex connection between politics and economics increases as industrial societies mature. The Great Depression and two world wars

transformed issues such as growth, income distribution, and stability from economic into political issues. More recently, a growing recognition of the public consequences of private decisions (e.g., environmental degradation, increasing inequality, and urban blight) is causing the public sector to encompass an ever-larger realm of human activity. Given the conflict over renegotiating the appropriate boundaries between public and private sectors, the holistic approach offered by political economy is increasingly relevant in analyzing and responding to the problems confronting modern societies.

NOTES

1. Harold D. Lasswell, *Politics—Who Gets What, When, How*. New York: Meridian Press, 1958.
2. Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Times*, 2nd ed. Boston: Beacon Press, 2004.
3. For elaboration on the concept of “authoritative allocation,” see David Easton, *A Framework for Political Analysis*. Englewood Cliffs, NJ: Prentice-Hall, 1965.
4. Charles Lindblom, *The Market System: What It Is, How It Works, and What To Make of It*. New Haven, CT: Yale University Press, 2001, p. 78.
5. See Gunnar Myrdal, *The Political Element in the Development of Economic Theory*, reprint edition. Piscataway, NJ: Transaction Publishers, 1990.
6. New institutional economics is presented in Douglas C. North, *Institutions, Institutional Change and Economic Performance*. New York: Cambridge University Press, 1990; Elinor Ostrom, *Governing the Commons: The Evolution of Institutions for Collective Action*. New York: Cambridge University Press, 1990; and Rudolph Richter, *Essays on New Institutional Economics*. New York: Springer, 2015.
7. For more on heterodox economics, see Ingrid Rima, *A Primer on Heterodox Economics*. New York: Routledge, 2016; Frederic Lee, *A History of Heterodox Economics: Challenging the Mainstream in the 20th Century*. New York: Routledge, 2009; and Julien-Francois Gerber and Rolf Steppacher, eds., *Towards an Integrated Paradigm in Heterodox Economics: Alternative Approaches to the Current Eco-Social Crisis*. New York: Palgrave Macmillan, 2012.
8. The concept of “mediating structures” is detailed in Peter L. Berger and Richard J. Neuhaus, *To Empower People: The Role of Mediating Structures in Public Policy*, 2nd ed. Washington, DC: American Enterprise Institute, 1996.

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Chapter 2

The History of Political Economy

A study of the history of opinion is a necessary preliminary to the emancipation of the mind.

John Maynard Keynes

He who knows only his own side of the case knows little of that.

John Stuart Mill

Current political and economic issues cannot be fully understood without some knowledge of the historical evolution of both institutions and ideas. Although the history of political economy remains obscure for most citizens, many of its ideas have been incorporated into the collective wisdom of society. In the words of John Maynard Keynes, “practical men who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.”¹ Before beginning a survey of the history of political economy, a word of caution is in order. All history is subject to interpretation, and the history of ideas is particularly controversial. No single interpretation of the history of political economy commands universal agreement among scholars.

ORIGINS OF POLITICAL ECONOMY

The period between the 14th and 19th centuries witnessed a “great transformation” in Western Europe as the feudal economy of the Middle Ages gradually transformed into capitalism.² The newly emerging market economy provided opportunities for the expression of individual aspirations previously suppressed by the laws and moral precepts of church, state, and community. Although political and religious leaders struggled to maintain control over society by placing limitations on the accumulation and use of property, the growing desire of individuals to free themselves from social constraints led to diminishing popular support for medieval institutions.

Along with changes in technology and commerce, new ideas were emerging. The Renaissance of the 14th century paved the way for the scientific inquiries of Copernicus, Galileo, Bacon, and Newton. Another impetus for change came from the Protestant Reformation initiated by Martin Luther in Germany. By the early 18th century, the Age of Reason, or Enlightenment, had arrived, and with it came a rejection of the medieval view of society as a divinely ordered hierarchy in which each person had a proper role and purpose. The new worldview was based on the autonomous individual and the human capacity for rational thought.

The Enlightenment was most prominent in France, where thinkers such as Voltaire, Diderot, D’Alembert, and Condillac sought to demolish superstition and tradition by subjecting all aspects of human existence to the scrutiny of reason. These philosophers believed that most human problems were attributable to poorly structured institutions and to uncritical acceptance of traditional authority emanating from church and state. They blamed prejudice, intolerance, and emotions for suppressing the human capacity to envision and construct a better society. The leaders of the Enlightenment were optimistic about the power of reason to clear away the debris of past oppression and error, leaving an open path for continual social improvement.

To liberate the human capacity for reason from the shackles of existing beliefs and traditions, Enlightenment thinkers demanded a critical reassessment of all social, political, and religious institutions. Only then could humans choose rationally without the taint of prejudice, habit, or superstition, and they would presumably choose to abolish all institutions

failing to promote the enlightened interests of mankind. Leaders of the Enlightenment called for nothing less than a total restructuring of society.

Science rose to prominence during this period because it seemed to offer a method for distinguishing between truth and superstition. By revealing the universal laws that govern nature and society, science would liberate mankind from both material deprivation and social oppression. Although the scientific method was initially used to understand the natural environment, it subsequently was applied to human existence, first to understand the functioning of the human body and then to investigate human behavior and social institutions. As Enlightenment thinkers began to discern predictable regularities in human interaction, they anticipated the construction of a science of society that would come to be called political economy.

The term *political economy* was introduced in 1616 by French writer Antoyne de Montchretien (1575–1621) in his book *Treatise on Political Economy*. The first known English usage occurred in 1767 with the publication of *Inquiry into the Principles of Political Economy* by Sir James Steuart (1712–1780). These early political economists sought to develop guidelines and offer policy recommendations for government efforts to stimulate commerce. Markets were still relatively undeveloped at the time, so governments took on significant responsibilities for opening new areas for trade, offering protection from competition, and providing control over product quality. The ideas and policies developed for this transitional stage between feudalism and capitalism came to be known as mercantilism. The early political economists thought that active involvement by government in the economy was necessary to promote economic prosperity.

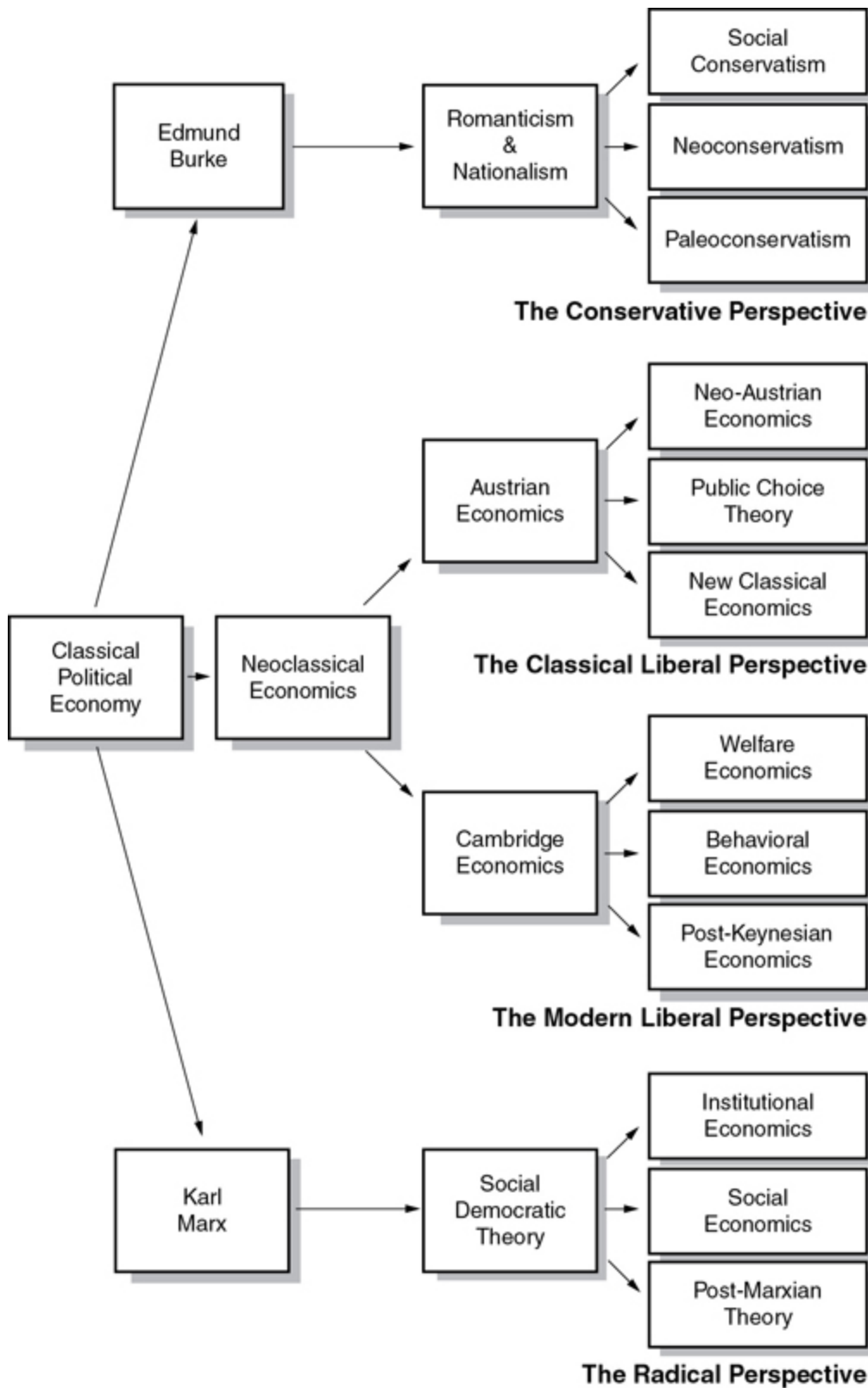
By the late 18th century, however, the prevailing attitude toward government changed dramatically. Many manufacturers and merchants perceived government not as a beneficent director of economic activities but as a major obstacle to the pursuit of wealth. Their hostility toward government was based on changing economic and political conditions. A flourishing market economy required that producers have access to resources in the form of easily purchasable commodities. In addition, both producers and consumers needed freedom to pursue their interests relatively unencumbered by social customs and political authority. Both these

conditions were rapidly materializing in England by the second half of the 18th century.

The formation of markets for resources proceeded along three lines. First, as landowners evicted tenant farmers from the land in order to graze sheep to supply wool for the emerging textile industry, a market for cheap and mobile labor developed. Second, the accumulation of wealth through piracy, looting, and early successes in commerce created a mass of financial capital available for investing and borrowing. Third, the confiscation and subsequent sale of church property and public land that had previously been available for common use created a market for land. As for political freedom, the combination of the Magna Carta, the English Civil War, and the Glorious Revolution of 1688 greatly diminished the power of the monarch and the aristocracy. With these changes in place, the market became a dynamic engine for the production of wealth, far overshadowing the power of government to dispense privileges and grant protection. The future was clearly discernible; the market would become the dominant institution for organizing society.

The subsequent evolution of political economy over the next two centuries is depicted in [Figure 2.1](#). The remainder of this chapter and the next four chapters are organized around this diagram.

Figure 2.1
The History of Political Economy



CLASSICAL POLITICAL ECONOMY

Adam Smith (1723–1790), a Scottish professor of moral philosophy, was fascinated by the market’s potential for promoting both individual freedom and material prosperity. Although he was not the first person to advocate laissez-faire policies by government, his book *The Wealth of Nations* (1776) presented the case for free markets with such wisdom that it formed the basis for a school of thought known as classical political economy. In addition to Smith, its leading proponents included Thomas Malthus (1766–1834), David Ricardo (1772–1823), Nassau Senior (1790–1864), and Jean Baptiste Say (1767–1832).

Classical political economists were both optimistic and pessimistic about the future of capitalism. They anticipated that the market economy would generate both increasing wealth and individual freedom without the need for supervision by church or state. In this sense, classical political economy is linked with the Enlightenment, demonstrating that when the shackles of religious and political restrictions are removed, individuals will prosper and society will remain orderly.

Yet, lurking beneath this rosy vision was impending disaster. Adam Smith repeatedly suggested that the market could not work its magic indefinitely. Malthus and Ricardo were even more pessimistic. With population growing rapidly and the available supply of land relatively fixed, they predicted an inevitable future of subsistence living for the vast majority of the population. Landlords would prosper as they received ever-larger rents due to the increasing demand for land on which to grow food, but capitalists’ profits would dwindle as they were forced to pay higher wages so that workers could afford to buy increasingly expensive food. Eventually, profits would be insufficient to provide capitalists with either the incentive or the means to expand production, and the entire economy would settle into a gloomy “stationary state” with no further growth.

Despite these predictions of widespread poverty and an end to growth, classical political economists remained largely committed to laissez-faire. The future would be grim, but attempts by government to intervene would only worsen the situation because government could control neither the scarcity of land nor the human tendency to overpopulate. The only relief would come from depopulation caused by plagues, famines, and wars, or from trade with other countries possessing plentiful land and cheap food. In the meantime, the stationary state could be delayed by keeping production

costs as low as possible, meaning that any efforts to raise wages or regulate businesses would harm the economy.

THE RADICAL EXTENSION

As classical political economy veered toward pessimism, Radical theorists continued to defend the Enlightenment vision of continual progress through the rational reconstruction of society. From the Radical perspective, the classical political economists were failing to carry out the mission of the Enlightenment. Although the power of the state and church had been successfully challenged, the power of property owners had actually increased due to the elimination of most government restraints. In the spirit of the Enlightenment, Radicals demanded that every aspect of society be subjected to criticism to see whether it could withstand the test of reason. The rights of property owners were viewed as no more sacrosanct than the authority of church or state.

Central to the Radical call for a reconstruction of society was a strong commitment to egalitarianism. Until all persons directly participated in the formation of the institutions governing their lives and shared in the benefits derived from those institutions, society's institutions would necessarily appear arbitrary and oppressive. Radicals condemned private property for breeding selfish interests conflicting with the common good of society. In a private property system, individuals have opposing interests and social cohesion disintegrates as the owners of property oppress those with little or no property. Sharp inequalities in property holdings make the poor vulnerable to exploitation as the threat of starvation coerces them to work for subsistence wages.

Radicals also condemned private property for alienating individuals from any sense of community or control over their work. Relying on the optimism of the Enlightenment, they concluded that humans could join together to collectively restructure the institutions governing their social interaction. Radicals envisioned a classless society in which free individuals would live in harmony with each other in their work, their communities, and their government. Such a society would be egalitarian and communal, with citizens sharing a broad range of common interests, including a commitment to maintain appropriate conditions for the development and

security of every person. From the Radical perspective, genuine freedom requires access to sufficient resources for well-rounded human development and hence can be secured only when the community as a whole controls productive property.

Examples of early Radical thinkers include William Godwin (1756–1836) in England, Thomas Paine (1737–1809) in the United States, and Marquis de Condorcet (1743–1794) in France. These writers were opposed not so much to the principle of private property as to the excessive concentration of ownership that restricted the opportunities and freedom of the majority of the population. In the early 1800s, writers such as Robert Owen (1771–1858) in England and Charles Fourier (1772–1837) and Henri de Saint-Simon (1760–1825) in France popularized the idea of eliminating private property. These “utopian socialists” formulated detailed plans for small communities based on shared ownership of property. Owen actually put his ideas into practice, moving to the United States with a group of followers to establish a community in Indiana called New Harmony. Hundreds of other small experiments with communal living occurred during the 19th century in both Europe and North America. Growing apprehension over the effects of industrialization and modernization undoubtedly spurred this interest in alternative forms of society. The loss of tradition, the squalor of large cities, and conditions in the early factories persuaded many people that fundamental change was required to improve the quality of human existence.

The influence of Radical thought was heightened immeasurably by Karl Marx (1818–1883), a German philosopher and political economist who constructed an impressive theoretical analysis of capitalism by weaving together classical political economy, the ideas of the German philosopher G. W. F. Hegel (1770–1831), and the communal vision of the utopian socialists. Building on the pessimistic theories of the classical political economists, Marx developed an elaborate theoretical argument that capitalism would eventually crumble and be replaced by a society in which the means of production were communally owned and operated. This new society, Marx claimed, was incubating within capitalism and its birth would coincide with the death of the parent. Thus, unlike the utopian socialists who sought to turn their backs on capitalist society, Marx portrayed capitalism as the essential precondition for a new and better organization of

society. In capitalist factories, workers were acquiring the technical knowledge, cooperative skills, and sense of solidarity that would enable them to revolt and establish a communal society.

After Marx's death, his ideas inspired several distinct political traditions. Some Radical theorists, including Georgi Plekhanov (1857–1918) in Russia and Karl Liebknecht (1871–1919) and Karl Kautsky (1854–1938) in Germany, upheld Marx's belief in the historical inevitability of communism. However, when a proletarian revolution failed to appear by the early 20th century, Russian theorists V. I. Lenin (1870–1924) and Leon Trotsky (1879–1940) introduced into Marxism the notion of a “vanguard party” of intellectuals who would lead the workers in the struggle for socialism. This strand of Marxism served as the theoretical basis for the Soviet Union.

In Western Europe and the United States, a different revision of Marx's ideas was formulated by theorists such as Edward Bernstein (1850–1932) in Germany, Sidney and Beatrice Webb (1859–1947 and 1858–1943) in England, Jean Jaurès (1859–1914) in France, and Eugene Debs (1855–1926) and Norman Thomas (1884–1968) in the United States. Acknowledging the rising standard of living enjoyed by workers in capitalist societies, these “social democrats” rejected the Marxian concept of proletarian revolution. Instead, they defended socialism as a more just and efficient economic system whose obvious appeal to the working class would permit an evolutionary transition from capitalism to socialism through the democratic political process. The task of the social democrats was not to foment revolution but to establish a working-class political party and to educate all citizens about the virtues of socialism.

Another important figure in the historical evolution of Radical thought was the U.S. economist Thorstein Veblen (1857–1929). Veblen rejected much of Marxism as being unscientific and metaphysical, but he remained a trenchant critic of capitalism. His ideas became influential in the early 20th-century Progressive reform movement in the United States that sought to enlarge the role of government in coordinating economic activity.

THE CONSERVATIVE RESPONSE

The progress fostered by the Enlightenment was a mixed blessing. The attack on repressive social institutions broadened the scope for individual initiative, resulting in the industrialization and urbanization of Western Europe. However, the disintegration of the traditional social order created both economic and emotional insecurity for many people. Unlike capitalism, feudalism had been based on stable, hierarchical social relations, with individual identity derived from one's role within a web of mutual expectations and duties. Feudalism repressed individual initiative, but it did provide familiarity and stability within a community. In contrast, the newly emerging industrial society wrenched people out of their accustomed roles. A person might grow up in a rural village, migrate to the nearest city, and seek employment in a factory surrounded by hundreds of other similarly uprooted workers. People no longer felt "at home" in an unfamiliar world of anonymous strangers.

The market's need for readily available labor resulted in most citizens being separated from any viable means of self-sufficiency. Many small farmers, having lost their land, became itinerant workers available for hire. Skilled artisans, who might previously have been members of professional guilds, could not compete against mechanized industry and were forced to seek employment in the factories. Even aristocrats suffered declining power and status as capital replaced land as the primary source of wealth. With these changes, the social bonds maintaining the hierarchical structure of society began to unravel. People formerly enmeshed in extended families, neighborhoods, villages, and churches now faced the impersonal forces of the market with little social support.

The French Revolution of 1789 magnified concerns about a dark side of the Enlightenment. The linkage between this conflict and Enlightenment thinking is evidenced by the revolutionaries' call for "liberty, equality, fraternity." The chaos and bloodshed of the Revolution raised doubts about the effort to remake society in accordance with human reason. To halt the corrosive impact of the Enlightenment, some theorists initiated renewed defenses of traditional society.

Edmund Burke (1729–1797), an Irish member of the British Parliament, was among the first to develop a Conservative critique of the Enlightenment. Burke claimed that the Enlightenment effort to fundamentally restructure society was destroying the authority and

emotional attachments that unite individuals into communities. Self-interested individuals, he reasoned, will always resent authority for placing limitations on the scope of individual action. But without authority, all persons suffer as society degenerates into a morass of conflicting desires and passions. Rejecting the Enlightenment claim that human reason is a reliable guide for redesigning society, Burke proposed that the exercise of reason should be confined to efforts by individuals to improve their private lives. The grand schemes of intellectuals and utopians would only disrupt the traditional patterns of human existence and lead to chaos.

Attempting to develop a defense of established traditions, Burke and subsequent Conservatives looked back to the merits of medieval society. A stable social order must be grounded in traditional institutions such as the church and the patriarchal family. When efforts to reconstruct society destroy traditional institutions, individuals are uprooted from their customary roles in the community. Deprived of a cultural heritage, isolated individuals lose meaning in their lives, become concerned solely with the pursuit of immediate gratification, and neglect their duties to others and to society as a whole. From the Conservative perspective, the degeneration of the French Revolution into violent anarchy was the inevitable result of liberating individuals to freely pursue their self-interest. The Revolution foreshadowed an impending collapse of civilization that could be averted only by strengthening traditional values and institutions.

As the Enlightenment was sweeping Great Britain and France, a reaction was brewing in Germany. Having been subjected to military conquest by France and the threat of economic domination by British industry, many Germans expressed disdain toward the cultures of their western neighbors. Fearing the cosmopolitan values and lifestyles spawned by urban industrial society, they were determined to avoid disintegration of their own culture. This reaction to the Enlightenment has been labeled *romanticism*. Writers such as Johann Fichte (1762–1814), August von Schlegel (1767–1845), Friedrich von Schelling (1775–1854), and Johann Herder (1744–1803) expressed their opposition to the effects of modernization on Germanic culture. Whereas the Enlightenment stressed the rationality of humans, the importance of science, and the mechanical nature of reality, the German romantics defended the unpredictability and irrationality of humans, the importance of traditional culture in maintaining a cohesive society, and a

view of reality that included spiritual and even mystical elements. Rather than adopting the analytical methods of modern science, the romantics sought to develop their intuition and instincts, their passions and feelings, their appreciation of beauty, and their sense of harmony with nature. They believed that personal fulfillment could be achieved only within the context of a stable culture based on widely shared values. From their perspective, the Enlightenment view of humans as autonomous, rational calculators of self-interest merely described the sordid conditions of English culture. The autonomy so highly prized by Enlightenment thinkers was, for the romantics, isolation from the social bonds essential to human happiness.

Even England, the most industrialized country in the world at the time, experienced a flourishing romantic movement. Partly inspired by their German counterparts, British writers such as Samuel Taylor Coleridge (1772–1834), William Wordsworth (1770–1850), and William Blake (1757–1827) expressed the common theme that society had been damaged by modernization and industrialization. Blake referred to the early factories as “dark, satanic mills,” and English romantics were generally contemptuous of business and commerce. They sought happiness and fulfillment by turning away from modern society to focus on unspoiled nature and spiritual contemplation. Ironically, this inward focus on the self would subsequently steer many romantic writers toward support for liberal and radical notions of individual freedom from repressive social institutions. For this reason, romanticism later became ideologically ambiguous.

A similar ambiguity surrounds the second major thread of 19th-century Conservatism. Nationalism originally flourished as an outgrowth of the Enlightenment ideals of popular sovereignty and the rights of man. The idea that a group of people sharing a common language, culture, and heritage could collectively determine their future lay at the root of the French Revolution and many other conflicts of the late 18th and early 19th centuries. However, the alliance between nationalism and liberalism was short lived. Whereas liberalism originally stressed the rights of autonomous individuals, nationalism demands submersion of personal identity in the national group. After the defeat of Napoleon in 1815, a Conservative reaction swept across Europe as governments sought to strengthen their nations against demands for democracy and individual freedom.

By the mid-19th century, Conservatives in Europe had gained the upper hand in their battle against the forces unleashed by the Enlightenment. However, as increasing demands for democracy resulted in extending the right to vote, Conservatives realized that simply opposing modernization would not gain the support of working classes. Otto von Bismarck (1815–1898) in Germany and Benjamin Disraeli (1804–1881) in England sought to gain popular support for Conservative governments by establishing rudimentary welfare programs. Government would replace the aristocracy in taking responsibility for dispensing charity.

An even more important change in Conservatism was the harnessing of nationalist sentiments to promote the goals of stability, order, state power, and economic expansion. Conservatives claimed that a true nation is more than just a collection of individuals sharing the same geographic space. A nation is based on a common language, common bloodlines, and common culture. This emphasis on cultural purity led Conservative nationalists to oppose free trade. Any nation opening its borders to the free flow of people, resources, products, and ideas would gradually lose its unique identity, without which the shared values forming bonds between individuals disintegrate and a nation loses its vitality and power. Only government can effectively oppose the cosmopolitan influences of the international market economy. A strong government enables a nation to be self-determining, free from potential constraints imposed by other nations or by the competitive forces of the market.

Conservative nationalism is typically linked with cultural and political chauvinism, which explains why racial and ethnic strife, imperialism, and war have often accompanied strong nationalist sentiments. The desire for national sovereignty can result in military conquest to expand national borders or spheres of influence against real or imagined foreign threats. Nationalists also find war and imperialism to be useful in diverting public attention away from internal problems and toward the glory and prestige of the nation. Some Conservative writers even touted war as a rare opportunity for individuals to transcend the routine of everyday life and display the noble human sentiments of courage, valor, strength, and patriotism. An illustrious example of a 19th-century nationalist is the German historian and philosopher Heinrich von Treitschke (1834–1896), whose racist and

militarist writings would later provide inspiration for Adolf Hitler (1889–1945).

NEOCLASSICAL ECONOMICS

The rise of Radical and Conservative ideas established alternatives to classical political economy. However, both perspectives met with considerable opposition. Radicalism aroused fears of the confiscation of private property, while many regarded Conservatism as a threat to democracy and modernization. However, despite this resistance, the influence of classical political economy waned during the 19th century for several reasons. First, its predictions of widespread poverty and slowing growth failed to materialize, raising doubts about the theories underlying those forecasts. Also, Marx's use of classical political economy to attack capitalism caused mainstream political economists to dissociate themselves from the theories of Adam Smith and David Ricardo. Finally, the combination of an increasingly powerful working class and social problems accompanying industrialization created new demands for government intervention to improve education, old-age security, public health, and occupational safety. In the face of these pressures, the policy of *laissez-faire* became increasingly unpopular.

With the three dominant perspectives all seemingly flawed, an ideological vacuum was developing. The time was ripe for a new approach to political economy capable of defending both democracy and private property. In 1871, three theorists, writing separately and unknown to each other, simultaneously developed this new theory. Carl Menger (1840–1921) of Austria, Stanley Jevons (1835–1882) of England, and Leon Walras (1834–1910) of Switzerland changed the focus of political economy from the classical concern with growth and income distribution to a “neoclassical” orientation that dealt solely with the behavior of individual consumers and firms operating in competitive markets.

To emphasize their focus on individual choice, the neoclassical theorists even changed the name of their field of study. Jevons referred to political economy as “the old troublesome double-worded name of our science” and urged his colleagues to replace it with the term *economics*. His suggestion

quickly gained acceptance, and by the beginning of the 20th century, neoclassical economics had attained dominant status among competing perspectives in political economy. Neoclassical economists sought to construct a theory that matched the scientific rigor of physics. To achieve this goal, they relied on mathematics to depict the process by which the choices of individual consumers and producers led to a stable equilibrium for the economy as a whole. Under conditions of perfect competition, individuals would engage in mutually beneficial exchanges until they gained the most satisfaction possible from the resources at their command. Neoclassical economists used the term *efficiency* to describe this outcome. Having demonstrated that free markets result in efficiency, the neoclassical economists largely affirmed the classical prescription of laissez-faire while avoiding the troublesome notions of class conflict and economic stagnation.

Although early neoclassical economists shared many of the same values and tools of analysis, disagreement among economists in Austria and England gave rise to two separate traditions—Austrian economics and Cambridge economics. Austrian economists were undoubtedly influenced by the political climate in their country during the late 19th century. As the Habsburg empire was disintegrating, the working class grew increasingly receptive to socialist ideas. In this situation, a group of academic economists in Vienna, including Carl Menger, Friedrich von Wieser (1851–1926), and Eugen von Bohm-Bawerk (1851–1914), sought to demonstrate the appeal of a free-market economy with virtually no government intervention.

In addition to defending the virtues of capitalism, Austrian economists were harsh critics of Marxism and socialism. Ludwig von Mises (1881–1973) claimed that without the forces of supply and demand operating in a free market, prices could not accurately reflect consumer preferences or the relative scarcity of different resources. Socialist planners, he argued, could not possibly gather enough information about resource availability and consumer preferences to permit calculation of appropriate prices for all products and resources. As a result, shortages and surpluses for different commodities would inevitably plague a socialist economy and inefficiency would be rampant. Only capitalism provides incentives for individuals to gather the information required for efficient choices by allowing people to reap the rewards of their own foresight, initiative, and innovation.

In contrast to Austrian economists, Stanley Jevons and subsequent economists at Cambridge University recognized a more positive role for government. Although committed to preserving the freedom of individual choice, their analysis of market failures provided rationales for government intervention to improve the workings of the market. The most prominent of the early Cambridge economists, Alfred Marshall (1842–1924), demonstrated that economic efficiency could be enhanced by taxing those industries in which average costs rose as output expanded and using the revenue to subsidize those industries, such as utilities and transportation, in which average costs fell as they served more customers.

Another Cambridge economist, Arthur C. Pigou (1877–1959), developed the analysis of externalities, in which the market fails to allocate resources efficiently because the actions of one person or firm create costs or benefits that are not reflected in market prices. Pigou recommended taxation of those actions creating external costs and subsidies for actions creating external benefits. Since externalities are pervasive, the scope for government intervention created by this market failure is potentially quite large.

In 1933, Cambridge economist Joan Robinson (1903–1982) demonstrated that the absence of perfect competition causes an inefficient allocation of resources and exploitation of workers. She suggested that government could intervene either to promote competition or to directly respond to the problems caused by lack of competition. Three years later, the most significant contribution from Cambridge economists occurred with John Maynard Keynes's (1883–1946) claim that laissez-faire capitalism is inherently prone to recession and unemployment. To remedy this problem, he proposed active government policies to control the level of total spending in the economy.

MODERN POLITICAL ECONOMY

Within the field of political economy, four broad perspectives currently contend for prominence—Classical Liberalism, Radicalism, Conservatism, and Modern Liberalism. The persistence of these dramatically different viewpoints attests to an irreducible ideological element in political

economy. Scientific methods cannot resolve the disputes among alternative perspectives because their differences are ultimately based on commitments to conflicting values. To understand these divisions within political economy requires a brief review of the historical evolution of ideological labels.

The ideas associated with the Enlightenment have traditionally been called *liberal*. Liberalism defends individual freedom and rights against the arbitrary exercise of power by church, state, or other persons. This commitment to individual freedom and autonomy meant that liberalism was originally strongly egalitarian in supporting equal rights for all citizens. In contrast to the hierarchical structure of medieval society, liberals anticipated that protection of equal rights would lead to substantially greater economic equality.

As liberals challenged aristocratic power and privileges, the labels *right* and *left* became integral to political discourse. In the French National Assembly of 1789, the defenders of aristocratic privilege and hierarchy stood on the right side of the chamber, while the proponents of greater equality and individual freedom stood on the left. As a result, proponents of equality have since been called *leftists*, while those who defend hierarchy are called *rightists*.

Rightists claim that hierarchical social relations are essential to a good society. Individuals need distinctions of status to differentiate themselves from others. A society lacking sufficient hierarchy will fail to provide incentives for citizens to excel, resulting in a stifling mediocrity and dragging the entire society into economic stagnation, boredom, and apathy. Rightists also defend hierarchy as essential to organize the complex social processes needed to maintain prosperity and order. Just as armies rely on hierarchical chains of command to wage war, other institutions such as corporations, schools, and families also must be hierarchically structured to achieve their objectives.

Leftists, in contrast, claim that human development flourishes when individuals engage in cooperative relations that can thrive only when excessive differences in status, power, and wealth are eliminated. According to leftists, a society without substantial equality hinders the development of not only deprived persons but also those whose privileges undermine their motivation and sense of social responsibility. This

suppression of human development, together with the resentment and conflict engendered by sharp class distinctions, ultimately reduces the efficiency of the economy and the quality of life.

The right/left dichotomy is often treated as synonymous with the conservative/liberal dichotomy. Although this usage of ideological labels may have been appropriate for analyzing political debate in the late 18th century, modern discourse has become more complex. In addition to the dispute over hierarchy and equality, both rightists and leftists have developed internal splits over another question: should the private interests of individuals take precedence over the collective interests of society? Individualists defend the priority of individual interests, while communitarians place higher priority on the public interest.

Individualists claim that a community or nation has no collective interests other than the aggregation of the individual interests within it. Therefore, the notion of a public interest or common good is a myth; the good community is one that allows individuals to freely pursue their private interests. Individualists are not directly concerned about the well-being of the community because they remain confident that any community securing individual freedom and property rights will be made prosperous by the energies and talents of its citizens. For individualists, freedom means the right to pursue one's interests with minimal constraint by society.

In contrast, communitarians view human development as dependent on the quality of the social environment and therefore expect communities and nations to provide a supportive and nurturing environment. By themselves, individuals are rather helpless in the face of social forces over which they have no control, but the community as a whole can collectively engage in actions to facilitate the development and fulfillment of individual interests.

Individualists and communitarians attempt to discredit each other through caricature. Individualists portray communitarians as supporting "anthill" or "beehive" societies, in which members simply serve their assigned role with no room for individual creativity or expression. Communitarians accuse individualists of advocating an amoral society, in which selfish, isolated persons pursue their narrow interests constrained only by laws and the threat of punishment. Yet, communitarians are vigorous defenders of individual dignity, claiming that a nurturing community enables individuals to achieve their full potential. Conversely,

individualists value healthy communities but argue that communities are most peaceful and prosperous when individuals are free to pursue their interests within the context of secure property rights.

The debate between individualists and communitarians occurs on both the right and left sides of the political spectrum, resulting in four major perspectives within political economy. The differences among these perspectives are illustrated in [Figure 2.2](#).

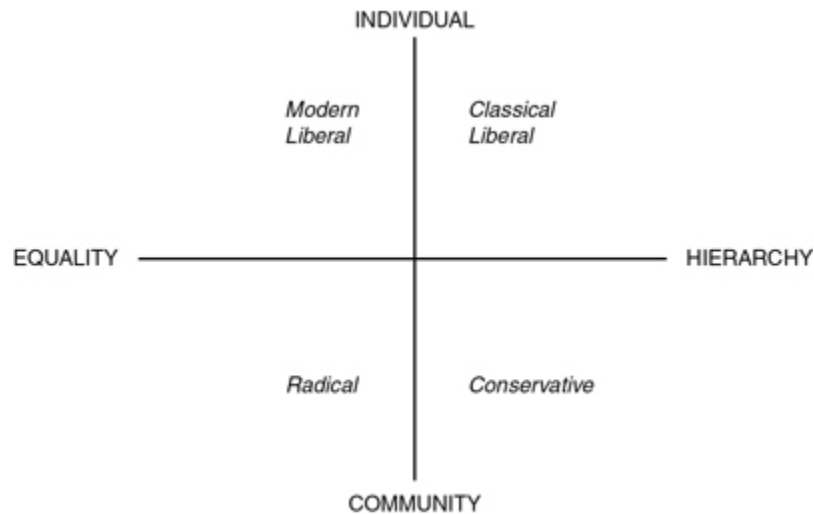
In the top-right quadrant, the Classical Liberal perspective is associated with both hierarchy and individualism. Although the earliest forms of liberal thought were highly egalitarian, by the beginning of the 19th century, many liberals concluded that the pursuit of individual freedom results in hierarchy and that hierarchy is essential for economic prosperity. Classical Liberalism was clearly articulated in the early 19th century by classical political economists and was later reinvigorated by neoclassical economists, particularly those of the Austrian school.

In the bottom-right quadrant, the Conservative perspective defends both hierarchy and community. Conservatives from Burke onward have not only stressed the importance of a harmonious community in molding virtuous persons but they also view hierarchy as essential to provide leadership by those with superior abilities. A hierarchical community establishes the authority and traditions essential for inspiring loyalty and allegiance among citizens and also provides the social context within which individuals can successfully find meaning and purpose in their lives.

The bottom-left quadrant portrays the Radical perspective combining commitments to both equality and community. Radicals uphold the original egalitarian impulse associated with early liberalism but view this goal as achievable only when the entire community is empowered to collectively establish institutions and allocate resources. Radicals believe that when all citizens participate in constructing society, both personal development and economic prosperity will flourish.

Figure 2.2

Value Commitments of Perspectives in Political Economy



Finally, the top-left quadrant illustrates the Modern Liberal perspective's simultaneous commitments to equality and individualism. Like Classical Liberals, Modern Liberals view individual autonomy as essential to guaranteeing both human dignity and a thriving economy. However, they also defend substantial equality as necessary for all persons to develop their capacities fully. Although Modern Liberals recognize potential conflicts between the values of individualism and equality, they remain confident that the two values can be compatible when the powers of government and the market are appropriately balanced.

The next four chapters examine each of these contending perspectives separately to develop an understanding of the value commitments underlying much of the controversy in political economy. This controversy represents more than mere academic debate; the future of mankind is literally at stake. To quote Keynes once more, "... the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else."³

NOTES

1. John Maynard Keynes, *The General Theory of Employment, Interest and Money* [1936]. New York: Harcourt, Brace, & World, 1965, p. 383.

2. See Karl Polanyi, *The Great Transformation: the Political and Economic Origins of Our Times*. 2nd ed. Boston: Beacon Press, 2004.

3. John Maynard Keynes, *op. cit.*, p. 383.

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PART II

CONTENDING PERSPECTIVES IN POLITICAL ECONOMY

Chapter 3

The Classical Liberal Perspective

Classical Liberalism developed simultaneously with the gradual emergence of capitalism. The same historical forces that gave rise to capitalism, including the determination of merchants and manufacturers to free themselves from the power of church and state, also gave rise to Classical Liberalism. The intellectual roots of Classical Liberalism reach back as far as the 14th century when the Italian Renaissance set in motion a series of intellectual changes, including the Enlightenment, the scientific revolution, and the Protestant Reformation. The common theme shared by all these transformations was the notion that human society would flourish if individuals were free to pursue their private interests without the arbitrary exercise of power by church or state. In contrast to medieval conceptions of society in which individuals were destined to play particular roles within a rigid social hierarchy, Classical Liberalism offered the vision of a society consisting of autonomous individuals pursuing their self-interest by engaging in voluntary exchanges. Individual success would be determined by each person's abilities and efforts to produce goods and services valued by others.

With its focus on individual choice as the primary determinant of social outcomes, Classical Liberalism is ideally suited for expression in the form of economic theory. In fact, the historical development of Classical

Liberalism aligns closely with the history of economic thought, starting with classical political economy, continuing with the Austrian branch of neoclassical economics, and culminating in a variety of current bodies of thought, including neo-Austrian economics, public choice theory, new classical economics, law and economics, new institutional economics, constitutional economics, libertarianism, supply-side economics, monetarism, and property-rights theory. In current political discourse, the term “neoliberalism” is often used to denote the modern revival of classical liberalism.

ARCHITECTS OF CLASSICAL LIBERALISM

Thomas Hobbes (1588–1679)

English philosopher Thomas Hobbes was one of the first social theorists to adopt the methods of the newly emerging natural sciences for the analysis of human behavior. Influenced by his contemporaries Francis Bacon (1561–1626) and Rene Descartes (1596–1650), Hobbes envisioned the world as a mechanical system operating according to precise laws of nature and devoid of any inherent meaning, purpose, or morality. To discover the natural laws governing society, Hobbes speculated about the behavior of individuals in a “state of nature” prior to the existence of government. Humans, he claimed, were constantly propelled into motion by the need to satisfy their appetites and desires. Although Hobbes acknowledged nonmaterial desires such as the need for social recognition or power, he claimed that such desires were typically met by accumulating wealth. If all individuals are engaged in the pursuit of wealth in the absence of government or morality, then the state of nature would inevitably be violent as humans are forced to become aggressive in order to protect themselves from others. Hobbes concluded that in a state of nature, life would be “solitary, poor, nasty, brutish, and short” because a “war of all against all” would result from the unrestrained pursuit of wealth.

Since nobody would want to live in such a situation, Hobbes reasoned that self-interested persons would voluntarily enter into a “social contract”

with others to establish a government with absolute authority to define and protect individual rights. Two points about the social contract are noteworthy. First, all citizens must be treated equally under the law since they would not agree to a social contract in which they were treated differently than other individuals. Second, since the authority of government is based on a hypothetical social contract, the government must serve the interests of the people. Hobbes rejected previous justifications of government power based on the “divine right” of monarchs.

The Hobbesian legacy had a major impact on Classical Liberalism. By beginning his theorizing with the isolated individual in a state of nature, Hobbes portrayed society and government as secondary and artificial creations. The pursuit of private interests is presumed to be the only purpose of human existence; politics is merely necessary to maintain social order. Hobbes rejected the earlier Aristotelian notion of political activity as the site of human development gained through participation in public life.

Despite Hobbes’s strong commitment to individualism, he concluded that government must have absolute authority to establish and enforce laws. So long as the monarch maintained public order and enforced the law uniformly, citizens had no right to resist royal authority. The title of Hobbes’s major book *Leviathan* (1651) has become synonymous with an authoritarian state. Ironically, although Hobbes was a founder of Classical Liberalism, his conclusions about the scope of government authority have been rejected by subsequent Classical Liberals.

John Locke (1632–1704)

John Locke, an English philosopher and physician, followed Hobbes in basing his theories on assumptions about individuals in a state of nature. Like Hobbes, Locke assumed that humans were acquisitive and self-interested, but he believed that a human capacity for reason enabled people to discover “natural laws” that would serve as guides both for restraining the pursuit of self-interest and for defining the proper role of government. Whereas Hobbes relied on government to establish and protect property rights because his pessimistic view of humans made the “state of nature” an arena of violence, Locke claimed that property rights based on human

reason existed in the state of nature, and therefore, government's authority was limited to protecting those natural rights.

In *Two Treatises of Government* (1689), Locke claimed that people's ownership of themselves and their labor is a self-evident truth. When individuals mix their labor with a part of nature unclaimed by anyone else, that portion of nature becomes their property. Since this process requires no government action or consent of others, Locke concluded that property rights are natural and, therefore, no person or government can legitimately violate them.

Locke's writings exhibit the dual commitment of Enlightenment thinkers to freedom and equality. His explanation of the origins of property rights would seem to support unlimited accumulation of property and therefore substantial inequality. However, Locke attached two "provisos" to the right to obtain property—property must be used without spoilage or waste and any claim to property is valid only when "there is enough, and as good left in common for others." Yet, having placed these limits on accumulation, Locke proceeded to remove them. He argued that the use of money permits people to accumulate wealth without spoilage and that the "enough and as good" restriction becomes impractical once all valuable land in a country has been claimed.

Locke's apparent acceptance of unlimited accumulation should be understood within its historical context. At the dawn of the capitalist era, liberal thinkers were confident that individual rights and freedom would result in substantially more equality than had existed in medieval society. Locke's defense of freedom to accumulate wealth was not insensitive to those who lacked property. He argued that private property benefits all persons in society because poor citizens are better off as wage laborers in a private-property system than if they were living in a primitive society with communal ownership. This shift from defending property as a natural right to defending property for its social benefits is the beginning of a split within Classical Liberalism that would ultimately give birth to a new perspective—Modern Liberalism.

Adam Smith (1723–1790)

Adam Smith, a Scottish professor of moral philosophy, was the first to fully articulate Classical Liberalism as a theory of markets rather than an explanation of political rights and obligations. By Smith's time, the major political conflicts in Great Britain regarding the power of monarchs had been largely resolved, and the task at hand was to raise the material standard of living.

In his first major work, *The Theory of Moral Sentiments* (1759), Smith argued that humans have an innate capacity for sympathy that enables them to see beyond their narrow self-interest and to view situations from the perspective of an "impartial spectator." The capacity for sympathy would restrain aggressive, selfish behavior and lead to a stable, orderly society. Yet, Smith's confidence in the power of human sympathy began to erode as he witnessed the emergence of capitalism and the unleashing of powerful and potentially dangerous motives such as greed, envy, and selfishness. As the pursuit of self-interest began to dominate society, Smith wondered whether virtue and morality could survive the competitive struggle for wealth.

Motivated by these concerns, Smith turned his attention from moral philosophy to political economy. After being introduced to the idea of laissez-faire by a group of French political economists known as the physiocrats, he concluded that a market society could not only withstand the effects of acquisitive selfishness but could also actually steer this "vice" into productive and socially beneficial channels. Without meaning to do so, self-interested individuals actually promote the good of society by engaging their talents and resources in the most profitable use. By the time he published *The Wealth of Nations* in 1776, Adam Smith had substituted the competitive market for human sympathy as the key to reconciling self-interest with an orderly and prosperous society.

Although Smith is often portrayed as the champion of capitalism, he was not completely optimistic about the market. He found self-interest compatible with the public good only when competition prevailed, and he warned that merchants and manufacturers would constantly seek to suppress competition and deceive the public in order to increase profits. Smith also expressed concern about the well-being of workers in a capitalist economy. While he recognized the tremendous efficiency gained by dividing production into separate, routine tasks, he worried that the

monotony and mindlessness of factory jobs would render workers “as stupid as it is possible for a human being to become.” Finally, Smith set the tone for subsequent classical political economists with his fear that the dynamism and growth of a market society would eventually come to an end as profitable investment opportunities were exhausted. Despite his qualms about capitalism, Adam Smith’s legacy has been the ideological defense of free markets and nonintervention by government. He proposed that government should be limited to three functions: law enforcement, printing of money, and provision of essential public goods such as harbors and roads.

Thomas Malthus (1766–1834)

Malthus was a professor of history and political economy at the East India College in England. More than any other classical theorist, he was responsible for steering Classical Liberalism away from its earlier predisposition toward the Enlightenment values of optimism, egalitarianism, and faith in reason. In contrast, Malthus believed that human misery was caused by nature rather than badly organized institutions. In his book *An Essay on the Principle of Population* (1798), Malthus claimed that limited supplies of fertile land would prevent agricultural output from increasing as quickly as the population and, therefore, hunger and misery were the inevitable fate of mankind.

For Malthus, there were only two restraints on population growth. “Positive checks” such as famines, plagues, and wars raised the death rate, while “preventive checks” such as delayed marriages and “moral restraint” lowered the birth rate. Malthus had little hope that humans were capable of reducing the birth rate, so the positive checks would be the only effective controls on overpopulation. Therefore, Malthus urged government to refrain from interfering with the operation of these positive checks. He proposed that raw sewage be permitted to flow in the streets, that insect-infested swamps remain undrained, and that cures for disease be suppressed, thereby allowing nature to carry out the grisly task of limiting population growth.

In addition to rejecting efforts to help the poor, Malthus argued that the privileges and wealth of the upper classes benefitted all of society. He reasoned that workers as a group received insufficient wages to permit them

to purchase the vast array of goods being produced by the new factories, so the economy would be plagued by periodic “gluts” of unsold goods unless some members of society could afford to spend large amounts on consumption without adding to production. Lavish consumption by the rich was therefore essential to maintain high levels of employment.

Malthus represents a turning point in Classical Liberalism. The Enlightenment attack on aristocratic privilege evolved into a defense of capitalist inequality. Later in the 19th century, Malthus’s ideas would resurface as “social Darwinism.” Relying on the evolutionary theory of Charles Darwin, Herbert Spencer (1820–1903) in England and William Graham Sumner (1840–1910) in the United States claimed that the human species evolves according to the principle of “survival of the fittest.” Any attempts by government to aid the poor would cause deterioration of the human gene pool by allowing unfit members of the human species to survive and reproduce. This biological argument for hierarchy and inequality became a powerful ideological force in Europe and the United States.

Friedrich A. Hayek (1899–1992)

Although born in Austria, Hayek spent most of his adult life in England and the United States, where he devoted himself to defending laissez-faire capitalism against the challenges posed by Conservatives, Modern Liberals, and Radicals. In *The Road to Serfdom* (1944), Hayek rejected the notion of a middle ground between capitalism and socialism, claiming that the concept of a “mixed economy” is untenable. Government intervention disrupts the smooth functioning of a free-market economy, thereby generating the need for additional corrective intervention. This vicious circle by which government-induced problems lead to a larger role for government will eventually push society toward socialism. The only way to halt this self-reinforcing process is to resist the initial temptation to improve society through government action.

The movement of Classical Liberalism away from the Enlightenment’s optimism and confidence in human reason can be clearly discerned in Hayek’s writings. He defended the market not because he believed in the power of individual reason, but rather because of his skepticism about the

capacity of the human mind to process information and accumulate knowledge. Since each person can have detailed knowledge of only a small portion of society, humans lack sufficient knowledge to plan or direct the entire economy. Hayek explicitly denounced what he called “constructivist rationalism,” which seeks to remake society in accordance with more humane and enlightened values.

Hayek praised the market for upholding individual freedom and emphasized its ability to process and communicate vast amounts of information about individual preferences, availability of resources, and technology. Since prices reflect the conditions underlying supply and demand, individuals are able to compensate for their personal lack of knowledge by simply comparing prices. Moreover, through their own particular experience, individuals gain specialized knowledge of niches in the market and may take advantage of any profitable opportunities they discover.

Hayek’s distrust of human reason led him to oppose virtually all government activity on the grounds that politicians and bureaucrats cannot know what is best for society. The task of politics should be merely to establish a constitution and a body of laws restraining individuals from harming others. Hayek warned that when government is permitted to expand its activities beyond the protection of property rights, it will inevitably become the tool of special interests. Various groups will claim that government should promote their interests in order to advance the common good or to achieve social justice, but these appeals are simply disguised attempts to secure benefits from government that groups were unable to attain through the market. Hayek argued that there is no such thing as the “common good” since society is simply an aggregation of individuals with their separate private interests. The concept of social justice is a “mirage” based on the false supposition that some interests are more deserving of fulfillment than others.

Hayek also rejected the notion that economics can provide a scientific basis for predicting or attempting to control the future of the economy. Not only is the economy too complex to comprehend, individual behavior is unpredictable and therefore not amenable to scientific analysis. The most that economics can accomplish is to demonstrate the wisdom of free markets and minimal government.

Hayek opposed efforts by economists to identify market failures that might warrant government intervention. He claimed that the efficiency of the market in processing information, providing price signals to guide individual choice, and encouraging innovation more than offsets any inefficiency resulting from market failures such as lack of competition or lack of information. Moreover, government does not possess sufficient knowledge to improve the workings of the market. Government intervention is likely to cause greater disruption to the economy than any shortcomings of the market.

Robert Nozick (1938–2002)

A modern restatement of Classical Liberalism was presented by Harvard philosopher Robert Nozick in his book *Anarchy, State, and Utopia* (1974). Nozick argued that the free market distributes income fairly when the following three conditions are met: (1) property must be acquired without theft, fraud, or coercion; (2) transfers of property from one person to another must occur through free exchanges, inheritance, gifts, or charity; and (3) any property holdings failing to meet the first two requirements must be “rectified” through redistribution.

Nozick rejected the notion that justice requires any specific distribution of income. On the contrary, to achieve a particular pattern of distribution, government would have to redistribute income earned in the market, and this redistribution would violate individual liberty by confiscating legitimately earned income. Nozick also dismissed any conception of justice linking reward with individual merit. There are many possible criteria of merit including effort, need, productivity, contribution, social status, or virtue, but society has no way of objectively choosing from among these criteria. Therefore, Nozick argued, any effort to assess individual merit would be arbitrary.

Nozick instead proposed the following definition of justice: “from each as they choose, to each as they are chosen.” Each person’s income should be determined by his or her choices of what to offer in the market and by other people’s choices to buy that person’s goods or services. Personal income may be justifiably low if an individual chooses not to offer much or if what is offered is not desired by others.

Nozick regarded inequality as largely the result of individual choice. So long as people are free to choose, markets will tend to generate inequality, but this inequality will be fair. In fact, attempts by government to interfere with market distributions are the major cause of injustice. Nozick equated taxation with slavery, claiming that it forces citizens to work for the government. The only legitimate role of government is to serve as a “night watchman” protecting property rights and preserving individual liberty.

In every society, the historical accumulation of wealth sometimes involved theft, fraud, or coercion and, therefore, violated Nozick’s definition of legitimate acquisition of property. If property holdings are illegitimate, Nozick’s version of justice requires “rectification” through government redistribution. Nozick acknowledged that his arguments for laissez-faire are undercut by past injustices in the acquisition of property. He even conceded that because current poverty is most prevalent among the descendants of those who suffered from past injustices, government redistribution might legitimately attempt to make the poorest citizens as well off as possible. In summary, while Nozick defended laissez-faire in principle, his commitment to rectify past injustices led him to acknowledge the legitimacy of redistributive policies. Most Classical Liberals have been unwilling to accept this particular conclusion.

PRINCIPLES OF CLASSICAL LIBERALISM

The essential features of Classical Liberalism are contained in its definitions of some of the most controversial terms in political economy.

Human Nature. Humans are self-interested and capable of acting autonomously by using their capacity for reason to discover the most efficient means to satisfy their needs and desires.

Society. Society is an aggregation of individuals and has no goals or purposes of its own. The good society permits individuals to pursue their private interests free from arbitrary constraint.

Government. Individuals create government for the purpose of protecting their natural rights as defined by a constitution. Beyond this function,

government is best when it governs least.

Morality. No objective method exists for discerning which values are superior to others, and, therefore, individuals should be free to determine right and wrong based on their personal preferences. The only valid social value is the protection of freedom by enforcing individual rights.

Freedom. Freedom is the absence of coercion by government or by other people.

Authority. Legitimate authority arises only through the consent of individuals to relinquish a degree of their freedom and autonomy. For example, workers consent to authority in the workplace in exchange for a wage. Citizens consent to authority by government in exchange for protection of their rights.

Equality. Equality means equal opportunity to engage in economic activity and equal protection under the law.

Justice. Justice requires protection of individual rights established by the constitution and punishment for those who violate the rights of others.

Efficiency. Efficiency is a situation in which no person can be made better off without making someone else worse off. In other words, resources are allocated to those persons willing and able to pay for them.

CLASSICAL LIBERALISM TODAY

The Great Depression of the 1930s dealt a crushing blow to Classical Liberalism by persuading large numbers of citizens that the free market could not be trusted to organize economic activities. From the Depression to the 1970s, Classical Liberals were nearly absent from public discourse, the primary exception being some members of the economics department at the University of Chicago. However, the combination of high inflation, high unemployment, and slow growth during the 1970s set the stage for a resurgence of Classical Liberalism as journals, newspapers, and public debates were filled with Classical Liberal proposals for solving the crisis. Since the 1970s, virtually every country in the world has moved toward reductions in taxes, regulations, and government ownership. Three of the most prominent schools of thought in contemporary Classical Liberalism

are neo-Austrian economics, public choice theory, and new classical economics.

Neo-Austrian Economics

The conquest of Austria by the German army during World War II forced many intellectuals in that country to emigrate. Ludwig von Mises (1881–1973) and Friedrich A. Hayek were the principal carriers of Austrian economics to England and the United States. Although never fully embraced by mainstream economists, Mises and Hayek managed to gain the respect of influential economists such as Lionel Robbins (1898–1984), Fritz Machlup (1881–1973), Oskar Morgenstern (1902–1977), and Gottfried Haberler (1900–1995). More recently, a neo-Austrian school of thought has developed under the leadership of Israel Kirzner, Murray Rothbard (1926–1995), Leland Yeager, and Roger Garrison. Neo-Austrian writings are featured in the *Review of Austrian Economics*, the *Quarterly Journal of Austrian Economics*, and the *Critical Review*.

Although neo-Austrians are committed to free markets and individual liberty, they reject the neoclassical assumption that individuals possess full information. If full information prevailed, then socialist planners could conceivably replicate the allocation of resources performed by the market and the defense of private property would be weakened. Neo-Austrians willingly concede that markets are fraught with shortcomings, including monopolistic elements, uncertainty, and externalities. Their defense of the market rests not on its ability to allocate resources efficiently at any single point in time, but rather on its role as an engine for discovering and applying knowledge that increases productivity and raises standards of living. Individuals occupying unique niches in the market have the best information and the strongest incentive to innovate. No planning agency or bureaucracy can match the dynamism of entrepreneurs in pushing technology forward. In fact, according to neo-Austrians, government intervention will almost always be detrimental to the economy because government caters to special-interest groups rather than promoting the public interest.

Neo-Austrians reject the neoclassical effort to create a scientific economics analogous to physics. Without the neoclassical assumption of

rational individual choice, neo-Austrians rely less on mathematics and more on persuasive argument. They conclude that economics is largely a completed project. Having demonstrated the dynamism of markets and the failures of government, neo-Austrian economists have nothing left to do except to continue the effort to persuade other economists, politicians, and the public that laissez-faire is the best policy. The most significant impact of neo-Austrian economics on mainstream economics has been the development of game theory to illuminate situations in which decisions must be made without full information.¹

Public Choice Theory

In recognition of the growing power of government in capitalist societies, some Classical Liberal theorists have attempted to analyze political decision making by applying the same principles of rational individual choice used to explain the actions of consumers and firms. Rejecting the Modern Liberal view of government as an impartial promoter of the common good, public choice theorists claim that voters, bureaucrats, and politicians behave in the same fashion as do private consumers and producers—they pursue their private interests by seeking maximum gain at minimum cost. For example, citizens vote for candidates who will deliver the most benefits and the lowest taxes. Bureaucrats seek job security, high wages, professional advancement, and social status while minimizing their work effort. Politicians support public policies that will generate the most votes and campaign contributions for their next election.

Public choice theorists view politics as simply economic activity conducted in the public sphere of government instead of the private sphere of the market. This approach to political economy is sometimes called the “Virginia school” because its leading proponents taught at the University of Virginia in the 1960s, moved to Virginia Polytechnic Institute in the 1970s, and finally established a permanent base at George Mason University in Fairfax, Virginia, in the 1980s. The most prominent public choice theorist was James Buchanan (1919–2013), winner of the Nobel Prize in economics in 1986. Other notable members of this school of thought include Anthony Downs, Gordon Tullock (1922–2014), William Riker (1920–1993), and Richard McKenzie. Public choice theory is featured in the journals *Public*

Choice, Constitutional Political Economy, The European Journal of Political Economy, and Economics & Politics.

Public choice theorists uphold the Classical Liberal faith in free markets, but they express concern that democratic politics creates an avenue by which individuals and groups can gain economic benefits while spreading costs among all taxpayers. Because individuals can be expected to pursue their interests by any means available, ending this abuse of democracy requires strict constitutional limits confining government to its appropriate role as protector of property rights.²

New Classical Economics

When Keynesian policies faltered during the stagflation of the 1970s, Classical Liberals were quick to fill the theoretical void. Under the label “new classical economics,” they sought to revive the intellectual support for free markets and minimal government. Early proponents of new classical economics included Thomas Sargent, Neil Wallace, Robert Lucas, and Robert Barro. Articles written from this perspective can be found in the *Journal of Political Economy*, the *Quarterly Journal of Economics*, and the *American Economic Review*.

New classical economists focus on the role of expectations in affecting individual choice. Sargent and Wallace developed the theory of “rational expectations” to demonstrate the fallacy of Keynesian efforts to lower the rate of unemployment. Rational expectations mean that citizens make choices by taking into account any anticipated effects of government policy. When government attempts to stimulate the economy, citizens expect higher rates of inflation and raise their wage demands, thereby offsetting any tendency for employers to hire more workers. In short, any deliberate effort by government to increase economic activity will be frustrated by the reactions of citizens seeking to defend their income against anticipated inflation. New classical economists conclude that government cannot lower the level of unemployment through monetary and fiscal policy and, therefore, should abandon such attempts.³

Closely related to new classical economics are two other theoretical approaches—monetarism and supply-side economics. The former, championed by Milton Friedman (1912–2006), seeks to revive the classical

idea that the amount of money in the economy affects only prices and not the level of employment or output unless prices are inflexible due to government policies or monopoly elements in the economy. Monetarists conclude that active monetary policy by the Federal Reserve can have no positive impact on unemployment and, therefore, should be abandoned in favor of steady growth of the money supply at a rate sufficient to accommodate increases in real output.

Supply-side economics, associated most prominently with Arthur Laffer, is so named because it rejects the Keynesian focus on demand management and instead proposes to stimulate the economy through deregulation, tax cuts, and privatization to reduce business costs and thereby increase output. The policies of supply siders, monetarists, and new classical economists share the goal of minimizing the size and scope of government activity.

AN ASSESSMENT OF CLASSICAL LIBERALISM

Classical Liberalism originally provided the ideological ammunition to dislodge the feudal aristocracy from power and to create a society in which individual aspirations were encouraged and rewarded. With its insistence on the priority of individual liberty over all other values, Classical Liberalism has served as a bulwark against abuses of political power. The strength of Classical Liberalism lies in its recognition of an irreducible core of human existence that remains separate from—and in some cases opposed to—larger social processes. Any society that represses individual aspirations for distinction and uniqueness will lose the human energy unleashed by the pursuit of self-interest. This energy has been a mainspring of social and economic progress.

However, the changing nature of modern societies poses several challenges to Classical Liberalism's commitment to free markets. Industrialization and urbanization have generated a proliferation of external costs and benefits not registered by the market. Government intervention in the form of taxes, subsidies, regulations, or the creation of new markets is usually required to cope with externalities such as pollution.

In addition, the presence of economies of scale enables large corporations to drive smaller firms out of business and thereby suppress competition. However, without effective competition, the market is no longer reliable in guiding self-interested behavior into socially useful channels. The “invisible hand” of market competition envisioned by Adam Smith is replaced by the exercise of power to manipulate markets for private benefit. This same quest for wealth and power also motivates individuals and firms to form groups seeking government protection against the competitive pressures of the market. To resist these demands, government must be more powerful than the interest groups seeking to control it. Thus, Classical Liberals face the paradox that a powerful government may be necessary to prevent private interest groups from manipulating the market.

Finally, Classical Liberalism fails to adequately recognize the human desire for community and a sense of common purpose. Individuals want to pursue their private goals and achieve personal success, but they are also committed to collective goals and the quality of public life. In fact, as standards of living improve, quality-of-life issues become increasingly significant. Concerns about environmental degradation, crumbling infrastructure, crime, pandemics, and terrorism reflect a growing realization that personal well-being depends on vibrant and healthy social environments.

NOTES

1. For more on neo-Austrian economics, see Murray N. Rothbard, *Man, Economy, and State*, 2nd ed. Auburn, AL: Ludwig von Mises Institute, 2004; Alexander H. Shand, *The Capitalist Alternative: An Introduction to Neo-Austrian Economics*. New York: New York University Press, 1984; and Robert Higgs, *Against Leviathan: Government Power and a Free Society*. Oakland, CA: Independent Institute, 2005.

2. Public choice theory is presented in Dennis C. Mueller, *Public Choice III*. New York: Cambridge University Press, 2003; Gordon Tullock, Arthur Seldon, and Gordon L. Brady, *Government Failure: A Primer in Public Choice*. Washington, DC: Cato Institute, 2002; and Francesco Forte, *Principles of Public Economics: A Public Choice Approach*. Northampton, MA: Edward Elgar, 2011.

3. Additional details of new classical economics can be found in Kevin D. Hoover, *The New Classical Macroeconomics: A Skeptical Inquiry*. Oxford: Basil Blackwell, 1988; Stephen M. Sheffrin, *Rational Expectations*, 2nd ed. Cambridge, Cambridge University Press, 1996; and Peter

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Chapter 4

The Radical Perspective

Although Radical ideas can be traced to antiquity, modern Radicalism was born out of conflict between the egalitarian aspirations of the Enlightenment and the emerging power of owners of capital. Radicals claimed that democratic control of the means of production was essential to realizing the Enlightenment values of freedom, equality, and justice. During the 19th century, as Classical Liberalism became increasingly anti-egalitarian, Radicalism gained influence among the working class and intellectuals by raising the possibility of transcending capitalism to achieve a more humane, cooperative society.

The specter of socialism and communism was sufficiently threatening to motivate major revisions in liberal theory and policies. The extension of civil and human rights in democratic societies has provided individuals with a degree of security against competitive market forces. For example, government support for labor unions, a minimum wage, and welfare benefits tends to establish a “social wage” that may be higher than market-determined wages. Although Radicalism’s direct influence in the United States and Western Europe has been minimal, it is indirectly responsible for the emergence of Modern Liberalism and the corresponding rise of the welfare state and government regulation of business.

ARCHITECTS OF RADICALISM

Jean-Jacques Rousseau (1712–1778)

Unlike the Classical Liberal portrayal of humans as self-interested creatures who form communities and governments to establish laws protecting their individual rights, the French philosopher Rousseau claimed that humans need to engage in communities and politics in order to fully develop their potential. Without a network of social relations, the individual is isolated and unfulfilled. For Rousseau, “our sweetest existence is relative and collective, and our true ego is not completely inside us.”

Yet, despite his praise for social life, Rousseau was a trenchant critic of existing societies. In *Discourse on the Origin of Inequality* (1775), he blamed unequal holdings of property for distorting the naturally peaceful and cooperative nature of humans. Excessive inequality enabled wealthier individuals to dominate others, and this subordination led to selfish and competitive behavior as people sought to gain a modicum of security. Unlike Classical Liberal theorists, who attributed acquisitive materialism to human nature, Rousseau believed that humans adapt to their social circumstances. Different institutional arrangements would lead to different patterns of behavior. Rousseau proposed a reorganization of society to promote greater individual freedom, equality, and a sense of community.

In *On the Social Contract* (1762), Rousseau outlined the details of the ideal society. He advocated popular sovereignty in which all citizens would actively participate in politics. For Rousseau, government by the people meant more than the clashing of individual or group interests. The experience of living in a true democracy would teach citizenship skills, particularly the ability to identify one’s personal interests with the public interest. Rousseau called the public interest the *general will* and claimed that it reflected the interests of people in their roles as citizens rather than as private individuals. To assure that the *general will* would prevail, Rousseau proposed the abolition of all groups seeking to promote their own narrow interests at the expense of the well-being of society.

Each individual would be morally obliged to conform to the *general will*. Rousseau suggested that recalcitrant persons who placed their private interests above the good of society should be “forced to be free.” This phrase has echoed hauntingly in the 20th century as totalitarian regimes

have banished dissidents to labor camps and mental asylums for “reeducation.” However, Rousseau claimed that the opportunity to participate in shaping society’s rules and institutions would create the desire to protect and promote the interests of society. Participatory democracy was the key to solving the tension between individual freedom and social order. Individuals could conform to the *general will* and yet still be free if they participated in establishing the institutions by which they were governed. For Rousseau, government was not a threat to individual freedom if it functioned simply as a means by which citizens could realize and pursue their common interests.

To facilitate participatory democracy, Rousseau envisioned small communities in which private interests and the public interest would be harmonized through face-to-face dialogue among citizens. Ongoing discussion and debate would create shared values and a sense of solidarity. Rousseau also believed that democracy and freedom required greater equality of property holdings so that no citizen would be completely dependent on others for survival. This equality would be maintained by a progressive income tax, a tax on luxury goods, and government regulation of economic activity.

Although Rousseau was a trenchant critic of repressive governments, his legacy has provided ideological support for totalitarian regimes. By portraying narrow self-interest as immoral and damaging to society, Rousseau created the rationale for extending government control over all aspects of life to assure that private interests do not interfere with the public good. While Rousseau relied on small communities to harmonize private and public interests without coercion, the potential for oppression increases as the size of the community grows. If the community encompasses an entire nation, opportunities for meaningful political participation are necessarily limited, and any proclaimed *general will* is based on the decisions of a small ruling party. Without political participation, enforcement of the *general will* is likely to be perceived as oppressive by many citizens.

Karl Marx (1818–1883)

Marx, a German political economist, spent most of his adult life in London. After earning a doctorate in philosophy at the University of Berlin, where he was heavily influenced by the ideas of German philosopher G. W. F. Hegel (1770–1831), Marx discovered socialism by reading the works of utopian socialists, including Charles Fourier (1772–1837) and Henri de Saint-Simon (1760–1825). A friendship with Friedrich Engels (1820–1895) established a lifelong collaboration resulting in many coauthored works.

Marx believed that the material conditions of society, specifically the production process, exerted a profound influence on all other dimensions of human existence, including politics, religion, and ideas. Marx's critics have labeled his approach "economic determinism," but he acknowledged mutual interaction among the economy, other social institutions, and human consciousness. Marx mocked the utopian socialists for their naive belief that small groups of people could simply retreat from capitalist society to form communities based on shared property. Without the benefits of modern technology, the division of labor, and large-scale production, these communities would be doomed to poverty and failure. Marx was convinced that capitalism was a necessary historical stage to pave the way for socialism, so he dedicated himself to understanding the inner workings of the capitalist system and the reasons for its ultimate demise.

According to Marx, the accumulation of capital is the driving force shaping all other aspects of the capitalist system. In *Das Kapital* (1867), he analyzed the process by which capital expands through profitability. Because capital accumulation proceeds in a fashion largely independent of the will of any person or of society as a whole, Marx argued that capital, rather than government or citizens, is the actual ruler of society. Capital dictates both public policy and individual behavior. Whereas Classical Liberals defended the autonomy of capital as essential to protecting individual freedom from oppression by government and aristocrats, Marx argued that the power of capital subverted the ability of citizens to shape society in accordance with their democratically determined collective interests. In short, the freedom of capital meant a loss of freedom for people. Competitive market pressures forced even capitalists to adhere to the dictates of capital. They could not pay higher wages or provide safer workplaces without losing their competitive advantage over rival producers. Capitalists were not evil people; the blame for society's problems lay with

capital—that “cancerous cell” whose growth would eventually destroy existing society.

Marx’s claim that capital accumulation is the primary force shaping capitalist societies seems to imply that machines have a demonic control over human beings. However, Marx used the term *capital* to signify more than just machines and factories; capital is the social relationship between owners and workers. According to Marx, capital creates profits not because machines create value but because the dominant power of the owners of capital enables them to extract “surplus value” by paying workers a wage worth less than the value of their output. When Marx attributed exploitation and other social problems to “the logic of capital accumulation,” he was not blaming machines; instead, he faulted the class structure that enabled a small minority of the population to control the wealth generated by the labor of the majority.

Marx’s understanding of capitalism led him to predict that the system would result in a falling rate of profit, increasing centralization of ownership, the elimination of the middle class, and perpetual misery for workers. Yet, he also viewed capitalism as laying the groundwork for a future socialist society. In its short life span, capitalism had generated more technological development and accumulation of productive assets than had occurred in all previous history. Moreover, the experience of working in large factories caused workers to develop more cooperative attitudes and a greater sense of solidarity. The combination of class consciousness and the economic crises caused by falling profits would eventually trigger a proletarian revolution and the establishment of socialism.

Marx anticipated that a proletarian revolution would entail a massive uprising by a vast majority of the population and, therefore, would be quite democratic. To prevent a counterrevolution and to handle the administration of the new socialist society, a “dictatorship of the proletariat” would be necessary. However, even this dictatorship would be democratic insofar as it represented the interests of nearly all citizens and was oppressive to only ex-capitalists and reactionaries who attempted to resist the will of the people. In a socialist society, productive assets would be subject to public control and citizens would be paid according to their productive contribution to society.

After an unspecified number of years, socialism would complete the task of enlarging productive capacity and creating a more cooperative “socialist man.” At that point, a communist society would emerge in which the economy would operate according to the dictum: “from each according to his ability, to each according to his needs.” Marx predicted a “withering away of the state” since a highly cooperative society would have little need for police, courts, or prisons.

Edward Bernstein (1850–1932)

Because of his political activism, Edward Bernstein was exiled from his native Germany and lived in England from 1880 to 1901. Bernstein formed a strong friendship with Friedrich Engels and became a major figure in Marxist political circles. At the same time, however, Bernstein met Sidney and Beatrice Webb (1859–1947 and 1858–1943, respectively), who had founded a Radical group called the Fabian Society. Under the influence of the Fabians, Bernstein concluded that orthodox Marxism had been rendered obsolete by the evolving nature of capitalism. The middle class was growing rather than disappearing, workers’ standards of living were rising, ownership of capital was being dispersed through the public sale of corporate stock, and the increasing market power of large corporations was putting an end to cut-throat competition. Bernstein concluded that neither the collapse of capitalism nor a proletarian revolution was inevitable. Instead, socialism could be ushered in gradually and peacefully through the democratic political process because workers outnumbered capitalists. To facilitate this process, political leadership and educational programs were needed to persuade workers of the advantages of socialism over capitalism.

In *Evolutionary Socialism* (1899), Bernstein explicitly broke his allegiance to Marxism. He objected to the Hegelian aspects of Marxism that portrayed history as the inevitable movement toward a predetermined endpoint. In addition, Bernstein rejected Marx’s claims to have developed a science of society. Socialism, he claimed, would materialize not because “laws of motion” would determine the course of history but because socialism was a morally superior and hence more appealing system for a large majority of the population.

In place of Hegel, Bernstein relied on the ethics of the German philosopher Immanuel Kant (1724–1804) to argue that capitalism was immoral because it encouraged individuals to regard one another as means to achieve their own private ends. Socialism, by contrast, would enable humans to respect and be compassionate toward others without falling behind in a competitive struggle for dominance. Bernstein's ideas were important in establishing a Radical tradition known as "revisionism," which provided the basis for social democratic political parties throughout Europe.

Thorstein Veblen (1857–1929)

A distinctly U.S. brand of Radicalism was founded by Thorstein Veblen, a political economist whose caustic critique of corporate capitalism and bourgeois lifestyles had a significant influence on U.S. social theory. In his book *The Theory of the Leisure Class* (1899), Veblen contrasted "dynamic" aspects of society such as science, the use of tools, and the "instinct for workmanship," with "static" aspects such as superstition, ritual, and habit. Veblen praised modern technology for undermining old traditions and myths, but argued that capitalist production, with its focus on profits, tended to thwart the potential dynamism of technology.

Although capitalism was once a progressive force in vanquishing feudal customs and authority, it spawned a new privileged class. This "leisure class" had little direct involvement in production but lived in splendor on income derived from the ownership of property. Veblen argued that the leisure class interfered with the efficiency of capitalism by serving as role models for the rest of society. The extravagant lifestyles of the rich set a standard to which all other classes aspired. Unable to afford genuine luxury, the middle and lower classes attempted to emulate the leisure class by engaging in "conspicuous consumption." Since the motivation behind conspicuous consumption is to relieve the insecurity and sense of inferiority created by the existence of a leisure class, Veblen concluded that abolishing this class would conserve resources and make everyone happier.

Veblen also blamed the leisure class for an erosion of the "instinct for workmanship." While capitalism depends on the work ethic, Veblen argued that the frivolous lifestyles of the leisure class create frustration and resentment throughout society. Seeking to emulate the leisure class, people

develop an aversion to work and seek shortcuts to success. Even businesses are prone to this syndrome. Rather than engaging in innovation and the production of high-quality products, corporations try to manipulate the market and the consumer in pursuit of short-term profits. Veblen coined the term “planned obsolescence” to describe the manufacture of products that quickly deteriorate so that consumers will be forced to purchase replacements.

Veblen believed that large-scale technology inevitably led to concentrations of business power. Since returning to an earlier era of competitive capitalism was not a feasible option, Veblen proposed that control of corporations be delegated to engineers and scientists who, by virtue of their training and temperament, focus on efficiency and quality. By relying on “technocrats” to restore dynamism to modern societies, Veblen steered a path between capitalism and Marxian socialism. While convinced of the waste and inefficiency of modern capitalism, he was also critical of Marx and had no confidence in government to control the means of production. He anticipated that scientists and engineers would operate businesses in the public interest without the bureaucracy and concentration of power entailed by government ownership.

Veblen left a dual legacy. First, his ideas served as inspiration for the U.S. populist movement with its mistrust of corporations, government, and the rich. In the early 20th century, the Progressives and even the Democratic Party were influenced by Veblen as they attempted to clean up government and end business corruption. Second, Veblen provided the intellectual foundations for a tradition within political economy known as institutional economics.

V. I. Lenin (1870–1924)

Vladimir Ilyich Ulyanov, a Russian theorist and political activist who adopted the pseudonym “Lenin,” led the first successful socialist revolution in 1917. An extremely forceful personality and skilled debater, Lenin almost single-handedly refashioned Marxism to address the particular situation of Russia in the early 20th century. Because Marx wrote very little about conducting a revolution or about the nature of postrevolutionary society, Lenin faced a formidable task.

Marx envisioned socialism as arising from the misery and alienation of workers in the most advanced capitalist countries. Moreover, given Marx's predictions of centralized business power and a vanishing middle class, the workers would constitute a vast majority of the population so that a proletarian revolution would be spontaneous, widely supported, and democratic. In contrast, Lenin was faced with a backward country ruled by an autocratic tsar and lacking a large industrial working class. In *What Is To Be Done?* (1902), Lenin proposed that a "vanguard party" of dedicated intellectuals should take responsibility for initiating the revolution and providing leadership for the masses. He also urged Radicals to resist the temptation to join reform movements that would accomplish only minor changes in the status quo; a genuine revolution was the only solution to Russia's backwardness.

In *Imperialism, The Highest Stage of Capitalism* (1916), Lenin developed another theoretical argument favoring the possibility of revolution in Russia. He claimed that capitalism had evolved from its earlier competitive phase into a monopoly phase that required corporations to move beyond national boundaries in their quest for cheap resources and markets for their products. Imperialism had three major consequences. First, it generated higher profits, thereby permitting capitalists to pay higher wages to their workers in the industrialized countries of Western Europe and North America. Lenin concluded that workers in these countries had unwittingly become part of the exploiting class because they were benefitting from the profits extracted from their fellow workers in less-developed countries. As an "aristocracy of labor," workers in the industrialized countries could no longer be expected to provide the impetus for a socialist revolution. Second, increasing oppression of less-developed countries would fuel revolutionary anger outside the core of the global capitalist economy. Lenin argued that Russia, as the most backward of the European nations, was the "weakest link" in the capitalist chain and, therefore, would be the first to break. Finally, imperialism would lead to war between the advanced capitalist nations as they struggled for control of global resources and markets. Lenin viewed World War I as an imperialist conflict and was confident that the capitalist countries would devastate each other, leaving a political vacuum in which socialism would spread from Russia throughout Europe.

Lenin left an ambiguous legacy. His insistence on the role of a vanguard party in leading the revolution has given the Leninist tradition a permanent antidemocratic imprint. Leninism is associated with a mistrust of the masses and the consequent need for authoritarian leadership. Lenin is accused of establishing a brutal, paranoid style of governing that set the stage for later atrocities committed by Stalin. However, defenders of Lenin point out that he called for decentralization of power as soon as the revolution had succeeded and that he abandoned this policy only when the threat of counterrevolution and economic collapse endangered the new socialist society. When the crisis passed in 1921, he again initiated decentralization with the New Economic Policy. Had Lenin not died in 1924, the Soviet Union might have taken a dramatically different course than it did under Stalin.

Jürgen Habermas (1929–)

Habermas is a German social theorist whose prolific writings have had a major impact on Radical thought. Like many Radicals, Habermas was deeply disillusioned by Stalinism and the authoritarian nature of the Soviet Union. Rather than dismissing Soviet practices as an aberration from true Marxism, he has attempted to construct a new Radicalism more explicitly sensitive to concerns about individual freedom.

In *Knowledge and Human Interests* (1968), Habermas argued that humans have three distinct types of interests: an interest in controlling nature, an interest in improved communication with others, and an interest in eliminating oppressive social structures. He indicted capitalism for promoting the interest in control at the expense of the interests in communication and liberation. The profit motive constantly drives firms to increase technical efficiency, and this pressure spreads throughout society as education, social interaction, family life, and recreation become merely means to achieve the end of greater wealth. Instead of earning money to live a more expressive and fulfilling life, people learn to structure their lives to increase their earning potential.

In *Communication and the Evolution of Society* (1979), Habermas relied on the notion of “communicative ethics” to develop a critique of both capitalist and authoritarian socialist societies. If humans do indeed have an

interest in improved communication, then they will seek to remove any structures of domination in society that interfere with sincere and meaningful dialogue. Habermas defined an “ideal speech situation” as one in which neither party to a conversation has power over the other. The outcome of the dialogue will be determined by the quality of the ideas being exchanged, not by the relative power of the participants. He claimed that hierarchical power relations in capitalism and authoritarian socialism block the human interest in communication.

Habermas perceives the major challenge to capitalism coming not from workers demanding a more equal distribution of income but rather from the social movements that have coalesced around such issues as environmental protection, women’s liberation, and nuclear disarmament. The very success of capitalism in raising standards of living provides individuals with the freedom to focus on improving the quality of their lives. The major obstacle to this goal, according to Habermas, is the dominance of profit making and technical rationality over the human interests in expressive communication and liberation.

PRINCIPLES OF RADICALISM

The following definitions capture many of the essential features of the Radical perspective.

Human Nature. Humans have certain biological needs and a capacity for reason, but their social and natural environments significantly affect their consciousness and behavior. The social context provided by language, traditions, values, and modes of interaction is so essential to human development that individuals cannot fully realize their talents and capacities except in association with other persons.

Society. Society is more than just a collection of individuals. Society is a living organism into which individuals enter at birth and leave at death. Because society precedes the individual, it has interests apart from—and potentially conflicting with—any particular individual’s desires. A good society encourages the fullest possible range of personal development and social relations based on mutual respect.

Government. Government properly serves as the representative of the collective interests of citizens. Government permits citizens to do for themselves collectively what they cannot accomplish as individuals.

Morality. Although Marxists have traditionally rejected the notion of universal values, non-Marxist Radicals find a basis for morality in the human need for social relationships based on mutual respect. An individual action or a social system is immoral if it treats people as objects and demeans their humanity.

Freedom. Freedom is the ability to fully develop one's human capacities. Freedom can be achieved only in the context of a nurturing community based on cooperation and participation.

Authority. With the possible exception of revolutionary leadership, authority is legitimate only when democratically established, based on widespread participation, and publicly accountable.

Equality. Equality means not just equal opportunity but also substantial equality of result. To achieve equality may require taxation or even confiscation of property income along with governmental efforts to assist disadvantaged persons.

Justice. Justice requires that rewards are distributed in accordance with those rights established through the democratic political process. Citizens should have rights to the essential requirements for human development, including food, housing, and health care. Justice also includes the impartial administration of the law.

Efficiency. Efficiency is achieved when society's resources are used in a way that maximizes the attainment of society's goals, including not only prosperity but also justice and human development.

RADICALISM TODAY

The brutality of Stalinism during the early decades of the Soviet Union was a major blow to the credibility of Radical ideas. After World War II (WWII), the anticommunism of the McCarthy era effectively suppressed Radical voices in the United States until the 1960s. However, with the emergence of mass political movements for civil rights, student power, women's liberation, environmental protection, and an end to the war in

Vietnam, the Radical perspective enjoyed a renaissance. Three of the most important contemporary Radical schools of thought are institutional economics, social economics, and post-Marxian theory.

Institutional Economics

Institutional economics arose out of Thorstein Veblen's scathing criticism of both Marxism and neoclassical economics. Veblen found the neoclassical portrayal of autonomous individuals rationally pursuing maximum utility to be as implausible as the Hegelian philosophy underlying Marxism. He proposed to analyze the economy as an evolving process embedded in an institutional framework, including the legal system, political system, educational system, family life, work, customs, and ethics. Veblen was critical of traditional economics for treating the market as if it functioned independently of political, social, and cultural institutions.

Veblen himself was indebted to two major intellectual influences. The first was pragmatism, a philosophical method developed by John Dewey (1859–1952), William James (1842–1910), and Charles Sanders Peirce (1839–1914). Pragmatism evaluated moral principles and scientific beliefs by assessing their usefulness in solving practical problems. The second influence on Veblen was the “historical school” of political economy developed in Germany by Wilhelm Roscher (1817–1894) and Gustav Schmoller (1838–1917). The historical school emphasized the evolutionary nature of economic systems and the importance of constructing economic theory on a solid base of data gathered through empirical research. One of Veblen's teachers, Richard T. Ely (1854–1893), did graduate work in Germany during the 1870s and was largely responsible for introducing the ideas of the historical school to U.S. economists. Ely was the principal founder of the American Economic Association, the leading professional organization of economists.

Prior to World War II, institutionalism was the dominant approach to economics in the United States. In 1920, institutional economist Wesley C. Mitchell (1874–1948) established the National Bureau for Economic Research, which is today the leading private organization for gathering statistical data on the U.S. economy. During the 1930s, many of the economists advising Franklin Roosevelt in fashioning the New Deal were

institutionalists. At the University of Wisconsin, John R. Commons (1862–1945) created a flourishing center of institutional research, and Clarence Ayres (1891–1972) later did the same at the University of Texas.

Despite these successes, institutionalism lost its prominence after World War II. Its decline can be traced to three factors. First, the rise of McCarthyism and the Cold War created a political climate hostile to any ideas suggesting major restructuring of capitalist institutions. Second, the apparent success and acceptance of Keynesian economics eased many doubts about the viability of capitalism and undermined proposals for radical change. Third, the publication of Paul Samuelson's *Foundations of Economic Analysis* in 1949 marked the full-fledged mathematization of economic theory. Institutionalism is less suited for expression in mathematical form because it analyzes customary patterns of group behavior rather than the rational behavior of individuals. The institutional approach has been described as “storytelling,” relying on a narrative style to convey understanding of economic processes. As economists gained increasing influence in government policy making, the more “scientific” mathematical methods of neoclassical economics successfully dominated the less rigorous institutional approach.

Institutionalists claim that the neoclassical assumptions of rational consumers and perfect competition disguise the power relations and inefficiency of real-world capitalism. They devote much of their research to issues such as economic development and industrial organization, where the perfectly competitive neoclassical model is least appropriate. Institutionalists have been reluctant to specify their visions of the proper balance between market and government, but underlying their approach is an emphasis on the Radical values of equality and community.¹ Among the prominent contemporary institutionalists are Geoffrey Hodgson, J. Ron Stanfield, Daniel Bromley, and Anne Mayhew. Institutional writings are presented in the *Journal of Economic Issues*, the *Journal of Institutional Economics*, and the *Journal of Evolutionary Economics*.

Social Economics

The roots of social economics lie in 19th-century continental European economic thought. German and French political economists exhibited much

greater skepticism toward free markets than did their British counterparts. They were particularly concerned about the effects of markets on culture and the spiritual well-being of citizens. In 1931, Pope Pius XI issued an encyclical criticizing markets for undermining the moral basis of society. In 1941, the Catholic Economic Association (CEA) was founded in the United States as part of an effort to engage Christian ethics and economic theory. In 1970, the CEA changed its name to the Association for Social Economics and opened membership to non-Catholics.

Social economics also has secular roots. In 1936, John Maurice Clark (1884–1963), an ex-president of the American Economic Association, published *Preface to Social Economics*, in which he urged the inclusion of values and ethics in economic reasoning. Over the past half century, social economics has been closely linked with institutional economics as many of the same theorists identify with both schools of thought. Prominent contemporary social economists include Amitai Etzioni, John Davis, and Mark Lutz. The major journals in which writings from this tradition can be found are the *Review of Social Economy*, the *Forum for Social Economics*, and the *International Journal of Social Economics*.

Like institutional economists, social economists have devoted much of their effort to criticizing neoclassical economics and constructing alternative methods for analyzing economic activity. Social economics is touted as offering a more integrated, holistic, evolutionary approach, incorporating social, cultural, and political factors into its understanding of economic affairs. The ethical vision of social economists points toward greater equality, decentralization, and accountability of power, and the priority of human development over profit.²

Post-Marxian Theory

During the 19th and early 20th centuries, Marxism was hardly visible in the United States due to rising standards of living and government repression of Radical organizations. Even when the Great Depression triggered a resurgence of Radicalism, little of it was explicitly Marxist. By the 1950s, Marxian economics in the United States was confined primarily to the works of two theorists—Paul Sweezy (1910–2004), the editor of

Monthly Review, and Paul Baran (1909–1964), a professor of economics at Stanford University.

However, the 1960s witnessed a renewal of the Marxist tradition. Under the umbrella of the Union for Radical Political Economics, Marxism gained recognition as a legitimate field of scholarly research. However, few Marxists in the United States or Europe aligned themselves with the Soviet version of socialism as consisting of centralized planning, public ownership of the means of production, and an authoritarian government. Western Marxists sought to develop new critiques of capitalism that would eventually lead to decentralized, democratic, and participatory forms of socialism. By the time the Soviet Union collapsed in 1991, most Radicals affirmed the importance of Marx's analysis of capitalism, but few identified themselves as Marxists. The label "post-Marxist" refers to those theorists who reject fundamental components of Marxian economics, including the labor theory of value and the notion of the historical inevitability of socialism, but continue to envision the possibility of a postcapitalist society with shared prosperity, genuine democracy, and sustainable growth.

Whether this postcapitalist society is called socialism or a more humane and inclusive form of capitalism is largely a matter of semantics as most post-Marxists accept the presence of private property and markets in any future society. They criticize Marx for being insufficiently sensitive to issues of individuality, race, gender, and pluralism. Indeed, theorists from this perspective are so intent on preserving individual rights and enlarging the scope of freedom and democracy that they could be labeled "post-liberals" rather than post-Marxists. To prevent abuses of government power, post-Marxists emphasize the necessity of participatory democracy with elected officials and bureaucrats fully accountable for their actions and citizens actively involved in the political process. Another bulwark against tyranny in a postcapitalist society is democratization of the workplace, whereby workers have significant control over the production process. With these institutional safeguards, post-Marxists hope to minimize the tensions between individual freedom and social justice.³ Prominent post-Marxists include Samuel Bowles, Herbert Gintis, Thomas Weisskopf, and Erik Olin Wright. Post-Marxian ideas are presented in *Politics & Society, Socialist*

Review, Radical America, New Left Review, and Review of Radical Political Economics.

AN ASSESSMENT OF RADICALISM

Radicalism grew out of the industrialization process of Western Europe in the 19th century. A new class emerged lacking access to productive property and, therefore, having no means of support other than selling labor for wages. With the efficiency of capitalist production steadily undermining the self-sufficiency of rural villages, farmers flocked to cities, only to find squalor, disease, unsafe working conditions, and subsistence wages. As the bright future envisioned by Enlightenment thinkers failed to materialize, some intellectuals turned their attention toward large concentrations of industrial wealth as the last bastion of privilege and unaccountable power.

The perennial appeal of Radicalism is the vision of human liberation. Radicalism shares the hope fundamental to nearly all religions—the coming of a new age when people will live together in peace and prosperity. Radicalism offers the hope that citizens can gain control over their lives and destiny by collectively restructuring social and economic institutions. For those who feel powerless and oppressed, the opportunity for self-determination through cooperation has been a powerful magnet.

With its emphasis on the social dimension of human existence, Radicalism is attuned to the condemnation of selfishness prevalent in most religions and ethical systems. Even if the pursuit of self-interest promotes economic prosperity, theorists have perennially been concerned with its potential for undermining individual virtue and distorting human relations. By appealing to the human capacities for cooperation and compassion, Radicalism stakes out the moral high ground in its confrontation with liberal individualism.

Despite these strengths, the Radical perspective is currently in considerable disarray. Radicalism was badly tarnished by governments purportedly following Marxist principles. The bleak and oppressive conditions in communist nations created widespread disillusionment. In fact, with very few exceptions, every country in which socialism or communism was practiced is moving rapidly toward capitalism by

introducing private property, competition, profitability, and decentralized authority as solutions to the failures of a centrally planned economy.

Radicals initially anticipated that changes in Russia and Eastern Europe signaled not a rejection of socialism in favor of capitalism, but a victory of democracy over totalitarianism. With dictatorial regimes removed from power, they hoped that citizens might establish the first genuine forms of democratic socialism. However, these visions are fading as industrial assets in Russia and Eastern Europe are rapidly accumulating in the hands of small numbers of powerful individuals. Radicals now foresee a phase of “robber baron” capitalism resembling the U.S. economy in the late 19th century and express concern that reactionary nationalism or even fascism may develop as citizens express their dissatisfaction with this form of capitalism.

Even before the Soviet Union disintegrated, many Radicals were rethinking their principles in light of disappointment with existing socialist countries. Radicals now acknowledge that some of the problems traditionally blamed on capitalism may be inherent in any form of social organization. For example, the problem of motivating productive activity does not disappear with the advent of socialism nor does the problem of scarcity of resources and making choices between alternative uses of those resources. Not all conflicts in society are class conflicts and, therefore, not all conflicts will disappear with the elimination of social classes. Moreover, problems of individual loneliness, alienation, and frustration do not vanish along with capitalism. If conflict will persist in any future society, then Marx’s vision of communism as a society in which neither market nor government mediates conflict is an illusion. Government serves not only to represent the collective interests of society but also to resolve the conflicting interests of individuals and groups within society. Furthermore, given the inherent problems of relying on government to mediate all conflict, the market is essential to any society as an arena in which private individual interests are pursued and fulfilled. If markets and private property are incorporated into Radical proposals for social reform, then the sharp distinction between capitalism and socialism becomes irrelevant. The Radical vision may be called democratic socialism or inclusive capitalism, participatory socialism or humane capitalism, market socialism or managed capitalism.

The flaw with any pure form of Radicalism is neglect of the private sphere within which individuals formulate life plans and pursue interests. While humans may have significantly greater capacities for sympathy and cooperation than have yet been exhibited, an irreducible core of each person must remain self-interested. To completely merge one's identity with a larger group would mean the loss of any identity distinct from the group. Without individual aspirations to motivate action, no society can retain its vitality.

Stated differently, while free individuals might collectively choose to establish a more egalitarian and cooperative society, they cannot be expected to permit society to determine their destiny. In addition to their social selves, humans have private lives, and liberty must mean something other than conformance to the will of society. The compatibility between individual liberty and social solidarity is limited by the fact that individuals remain separate entities distinct from the society in which they live.

NOTES

1. For more on institutional economics, see Bernard Chavance, *Institutional Economics*. New York: Routledge, 2013; Geoffrey M. Hodgson, *The Evolution of Institutional Economics: Agency, Structure and Darwinism in American Institutionalism*. New York: Routledge, 2004; and William K. Kapp, *The Foundations of Institutional Economics*. New York: Routledge, 2011.

2. Details of social economics can be found in John B. Davis and Wilfred Dolfsman, eds., *The Elgar Companion to Social Economics*. Northampton, MA: Edward Elgar, 2008; Mark A. Lutz, *Economics for the Common Good: Two Centuries of Social Economic Thought in the Humanist Tradition*. New York: Routledge, 1999; and Simon N. Hellmich, "What Is Socioeconomics: An Overview of Theories, Methods, and Themes in the Field," *Forum for Social Economics*, 44(2015): 1–23.

3. Post-Marxian theory is presented in Samuel Bowles, Richard Edwards, and Frank Roosevelt. *Understanding Capitalism: Competition, Command, and Change*, 3rd ed. New York: Oxford University Press, 2005; Erik Olin Wright, *Envisioning Real Utopias*. London: Verso, 2010; and Stanley Aronowitz. *Left Turn: Forging a New Political Future*. Boulder, CO: Paradigm Publishers, 2006.

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Chapter 5

The Conservative Perspective

The meaning of the term *conservative* has evolved over time. It first appeared in political discourse after the French Revolution of 1789 degenerated into chaos and anarchy. Opponents of the Revolution sought to develop an ideological defense of the institutions of medieval society—the monarchy, the aristocracy, and the church. To preserve these hierarchical social structures, they opposed the Enlightenment ideals of equality, individual autonomy, democracy, and the unrestrained pursuit of material gain associated with free markets. Nineteenth-century Conservatism was a backward-looking reaction to the disintegration of traditional society caused by commerce, industrialization, and mass political movements in Europe. Conservatism was most influential in those countries least exposed to capitalism, meaning that Central and Eastern Europe were more conservative than the Western European countries with access to sea trade. In the United States, 19th-century Conservatism was primarily a southern phenomenon where the Conservative ideal of hierarchical communities served to legitimize the plantation system and slavery.

By the beginning of the 20th century, the expansion of capitalism and democracy had effectively marginalized Conservatism. However, the brutality of World War I revealed the perils associated with modernism. Contrary to the confidence of Enlightenment thinkers in the ability of

human reason to foster continual social progress, mankind seemed prone to irrationality and evil in using modern science and technology for destruction rather than liberation. As doubts about capitalism and liberal democracy began to flourish, both Radical and Conservative ideologies gained increasing support. In Russia, the reaction against capitalism took a Radical turn as the Bolshevik Revolution of 1917 established the first communist nation. Anticapitalist sentiments also manifested themselves in Conservative regimes as fascism appeared in Italy in 1922 and a decade later in Germany, Portugal, and Spain. Fascism relied on a charismatic leader to mobilize society in a quest to restore national strength and ethnic identity by suppressing the disintegrating forces of market competition, democratic political conflict, and individual self-interest.

At the end of World War II, Conservatism was tainted by its association with fascism. Classical Liberalism had also suffered a major setback as the Great Depression seemed to demonstrate the folly of laissez-faire capitalism. Recognizing their shared plight, Conservatives and Classical Liberals compromised with each other to form a rightist coalition. Classical Liberals accepted the Conservative ideals of national strength and preservation of cultural traditions, while Conservatives yielded to the Classical Liberal priorities of free markets and individual liberty. Modern Liberals facilitated this ideological realignment by attaching the label *conservative* to Classical Liberals so that Modern Liberalism could lay claim to the liberal tradition of expanding freedom and democracy.

The marriage of Classical Liberalism and Conservatism was advantageous to both groups. Most Conservatives were anxious to rid themselves of any association with fascism and to embrace capitalism and democracy as bulwarks against totalitarian regimes from both the left and the right. Classical Liberals, sensing that the tides of history were shifting against them, reached out to Conservatives as their most obvious allies in resisting growth of government and defending the unfettered rights of private property. This rightist coalition was institutionalized in 1946 with the establishment of the Foundation for Economic Education, which assembled U.S. corporate sponsors to fund research and publish papers and books defending the free enterprise system. The following year, Friedrich Hayek organized the Mont Pelerin Society, named after the Swiss town where the first conference was held, to provide an organization for

intellectuals seeking to defend free markets and reverse the trend toward expanding government power. Although Hayek, Milton Friedman, and other Classical Liberal members insisted they were not Conservatives, they made little effort to dispute the Modern Liberal claim to the liberal tradition.

In 1955, William F. Buckley Jr. (1925–2008) founded the *National Review* magazine to promote the fusion of Conservative and Classical Liberal perspectives. Conservatives suppressed their concerns about free markets and yielded to laissez-faire economic policies, while Classical Liberals accepted a larger role for government in policing internal dissent and challenging communism around the world. Since the 1950s, the term *conservative* has typically been used to denote the fusion of Classical Liberalism and Conservatism, while the label *liberal* is reserved for Modern Liberalism. Despite the fact that ideological defenses of free markets and individual liberty are now labeled *conservative*, this text will maintain the distinction between Conservatism and Classical Liberalism for several reasons. When Classical Liberalism is called *conservatism*, genuine Conservatism tends to be forgotten or ignored. Also, the goal of understanding the historical roots of modern debates is better achieved by maintaining continuity over time in the meaning of ideological labels. Finally, the alliance between Classical Liberals and Conservatives has unraveled in the absence of a global communist threat. Differences between Classical Liberal and Conservative perspectives are now an integral part of debates in political economy.

ARCHITECTS OF CONSERVATISM

Edmund Burke (1729–1797)

Burke, an Irish philosopher, political theorist, and member of the British Parliament, opposed royal authority and supported the U.S. quest for independence. However, the bloodshed and anarchy of the French Revolution persuaded him that a vigorous defense of traditional society was needed to prevent revolutionary sentiments from spreading throughout Europe. In *Reflections on the Revolution in France* (1790), Burke blamed

the Revolution on the Enlightenment ideal of a total restructuring of society in accordance with human reason. Burke viewed society as a fragile organism whose institutions are not products of rational human design but have evolved over the ages to suit the unique features of particular nations. Revolutionary change damages society because traditional values and beliefs represent the “collective wisdom of the ages.” Whereas the Enlightenment sought to replace prejudice and superstition with rational calculations of costs and benefits, Burke defended prejudice for upholding cultural norms and maintaining traditional behavior without requiring individuals to think about right or wrong.

According to Burke, humans are neither autonomous nor rational. They need the institutions, customs, and rules provided by society to channel their desires toward productive goals and to form personal identities. He viewed isolated individuals as incapable of achieving the fulfillment that comes from virtuous living within an orderly community. Fearing that traditional values of piety, duty, and patriotism had been vanquished by self-interested materialism, Burke declared: “The age of chivalry is gone. That of sophisters, economists, and calculators has succeeded, and the glory of Europe is extinguished forever.”

To provide individuals with moral guidance and authority, Burke proposed a national church and an aristocratic government. He distrusted democracy, arguing that the common person had neither the time nor inclination to acquire sufficient knowledge to vote wisely. Democracy would only turn the political process into a battle between competing private interests. Aristocrats, he believed, were ideally suited to govern because their wealth and leisure freed them from the scramble for personal gain, thereby enabling them to impartially promote the public interest.

Burke supported private property and a market economy, but he claimed that self-interest must be restrained by moral considerations. He urged business owners to behave in an honorable and chivalrous manner by placing their duties to society above their quest for maximum profit. For Burke, economic activity should remain relatively free from government intervention, but he looked to structures of authority in the private sector to curb the pursuit of self-interest. When authority is embedded in patriarchal families, hierarchical workplaces, and neighborhood associations, it would be accepted as natural by all citizens.

Thomas Carlyle (1795–1881)

Carlyle was a British historian who feared that capitalism was destroying the emotional bonds and sense of duty that made civilization possible. In particular, Carlyle scorned classical political economy, calling it “the dismal science” and “pig philosophy” because it portrayed society as an arena in which pleasure-seeking individuals engage in a continual struggle for material success.

In *On Heroes, Hero-Worship, and the Heroic in History* (1841), Carlyle defended a hierarchical society governed by charismatic leaders who could generate consensus among different groups. He claimed that certain individuals are born leaders and should be permitted to rise to positions of power. Although Carlyle favored an aristocratic government, he blamed the British aristocracy for participating in the capitalist pursuit of profit and thereby neglecting its duty to govern wisely. As a result, the public was demanding extensions of the right to vote, but Carlyle criticized democracy for creating a clamor of competing interests, each lacking a vision of the public good. His preferred model of government was revealed by his admiration of imperial Prussia where there were no political campaigns or elections, and leaders promoted the wisest and most capable individuals to positions of authority. Society should resemble an army in which hierarchical authority creates social order, discipline, cohesion, and a sense of purpose.

In addition to his rejection of democracy, Carlyle condemned liberal notions of freedom. When freedom is interpreted to mean that individuals have no restraints on the pursuit of self-interest, society will degenerate into chaos and anarchy. Genuine freedom is based on living virtuously in accordance with society’s shared values and goals. Carlyle feared that capitalism was undermining freedom and order by replacing traditional hierarchical authority based on virtue and wisdom with a new hierarchy based on wealth. Traditional hierarchy was a stabilizing force because each class recognized its duties and functions; the aristocracy would govern wisely, while the rest of the population labored and lived in peace. However, because capitalism promotes competition among self-interested individuals, the resulting hierarchy of wealth does not carry with it any sense of social obligation. Those who succeed feel no duty to wield their

power for the social good, and those who fail have little respect for or allegiance to society and its leaders.

To ameliorate the effects of capitalism, Carlyle proposed that political leaders should take responsibility for the moral and spiritual regeneration of society through a government-sponsored national church. In addition, government could provide public assistance programs, regulation of business, and efforts to improve social relations within factories. While granting that “despotism is essential in most enterprises,” Carlyle suggested that hierarchical authority would be more effective if workers developed an emotional attachment to their place of work through increased participation in the decision-making process. This proposal illustrates a recurring tendency in Conservative thought to offer quasi-socialist solutions to the problems of capitalist society. Conservatives share common ground with Radicals in viewing an active community life as necessary to counteract the destructive forces of competitive individualism.

Vilfredo Pareto (1848–1923)

An Italian economist and sociologist, Vilfredo Pareto spent most of his career at the University of Lausanne in Switzerland. Pareto’s fame derives primarily from his book *Manual of Political Economy* (1906), in which he argued that competitive markets and free trade result in an efficient allocation of resources. He defined efficiency, now referred to as “Pareto optimality,” as a situation in which no reallocation of resources can make one person better off without making another person worse off.

Despite his arguments for the economic advantages of free markets, Pareto’s Conservatism, exhibited in *The Mind and Society* (1916), led him to claim that all societies are naturally and inevitably controlled by elites. He even developed a mathematical formula known as “Pareto’s law,” demonstrating the degree of inequality that is natural for any society. In addition to defending hierarchy and inequality, Pareto argued that power passes back and forth between two fundamentally different elite groups. He used the label “foxes” to describe cunning, flexible, risk-taking elites. Foxes are likely to be innovative capitalists who thrive in a dynamic social environment. The second group, called lions, is resistant to change and willing to use force to defend the status quo. Lions are typically land-

owning aristocrats or that portion of the capitalist class no longer engaged in innovation and living on income from their ownership of assets.

When foxes control the government, society is dynamic and markets are relatively free, but foxes fail to exert the force necessary to maintain an orderly society. In particular, the openness and flexibility of a fox-controlled government permit nonelites such as workers and farmers to gain political power. In response to growing political instability, lions will overthrow the fox government in a “circulation of elites” and exert whatever force is necessary to restore order. Lions may suppress free trade and restrict democracy, but these actions protect property and profits from the threat of egalitarian social reforms.

Pareto believed that both foxes and lions were essential to society. Foxes sustain economic prosperity but fail to resist disorder, while lions defend private property but suppress the dynamism of the economy with their heavy-handed tactics. When Benito Mussolini and the Italian fascists took power in 1925, they honored Pareto as an intellectual founder and, indeed, the fascists were a classic example of a lion government. However, the fascists ignored Pareto’s prediction that lions would eventually be overthrown by proponents of democracy and free markets.

Joseph Schumpeter (1883–1950)

An Austrian native, Schumpeter studied under Friedrich von Wieser (1851–1926) and Eugen von Bohm-Bawerk (1851–1914) at the University of Vienna. Although he is sometimes linked with the Classical Liberalism of the Austrian school, he constructed a unique analysis of capitalism that places him within the Conservative perspective. After immigrating to the United States in 1931 to escape Nazism, Schumpeter taught for several decades at Harvard University.

In *The Theory of Economic Development* (1911), Schumpeter outlined his vision of capitalism. The driving force behind the system is the entrepreneur who, through continual innovation, creates profitable investment opportunities and thereby sustains economic growth. Paradoxically, the essential role of the entrepreneur is also the weak point of capitalism. In *Capitalism, Socialism and Democracy* (1942), Schumpeter praised successful entrepreneurs for creating huge enterprises with

sufficient resources to fund research and innovation. He had no doubt that corporate capitalism was far superior to the free-market competition of earlier periods. However, as scientists and professional managers took over the processes of innovation and administration, the entrepreneurial function was becoming increasingly obsolete. As a result, the success of capitalism in promoting efficiency was simultaneously destroying the very source of its own dynamism.

Another trend highlighted by Schumpeter was the democratizing of the political process. With special interests vying against each other to gain political power, Schumpeter believed that politicians seeking reelection would increasingly pander to narrow interests. A democratic government's tendency to experiment with reform and intervention would gradually undermine the traditional values and hierarchical social structures essential to maintaining the public's sense of patriotism, loyalty, and morality. Without these traditional sentiments to restrain self-interest, the disintegrating effects of competition and self-interest would cause the entire system to self-destruct.

As an example of the dangerous consequences of self-interest, Schumpeter claimed that capitalism threatens the nuclear family because fewer people will choose to marry or have children once they calculate the actual costs and benefits. The prosperity created by capitalism gives rise to a class of intellectuals who, frustrated by their failure to achieve the status and wealth of successful entrepreneurs, seek to turn public opinion against big business and private property. The relative power of intellectuals is heightened by the growing passivity of capitalists who, having withdrawn from active participation in production, lose their strong emotional attachment to private property. As absentee owners, the capitalists lack the character or motivation to resist their enemies.

Convinced that socialism would replace capitalism, Schumpeter tried to envision a socialism that would be acceptable to Conservatives. He conceded that capitalism was already largely socialized because the dynamic entrepreneur had been replaced by bureaucratic administrators. If socialism simply meant that government bureaucrats would replace corporate bureaucrats, there would be little impact on efficiency and government would gain greater control over the destructive tendencies of the market. With government and business working together to maintain a

stable, hierarchical society, socialism could be compatible with Conservative goals. However, the key to Conservative socialism is government's ability to administer the economy without being influenced by popular pressures and the demands of special-interest groups. To insulate government, Schumpeter opposed active and widespread participation by citizens in the political process. As long as the political realm remained sealed from democratic pressures, government administration of the economy might be better suited than capitalism to sustaining Conservative values of stability, order, and hierarchy.

Leo Strauss (1899–1973)

Strauss was a political philosopher at the University of Chicago who devoted his career to resolving what he called “the crisis of modernity”—the corrosive effects of the Enlightenment legacy of individualism, ethical relativism, and faith in technology. In *Natural Right and History* (1953), he contrasted two conceptions of natural rights. In Greek and early Christian society, natural rights were based on a morality existing independently of individual desires. Humans had a moral duty to seek the good, and the purpose of politics was to cultivate virtue among citizens.

By contrast, early liberal theorists such as Hobbes and Locke used the notion of natural rights to refer to the rights of autonomous individuals to pursue their self-interest without arbitrary restraint by government. This liberal version of natural rights broke the connection between rights and corresponding moral duties. By contributing to the toppling of the aristocratic power structure, Hobbes and Locke opened a Pandora's box of social disruptions. According to Strauss, when moral issues are relegated to individual choice, society loses any standards of truth, justice, and beauty. By elevating individual freedom and autonomy above all other social values, liberalism transforms society into a mass of rootless individuals pursuing their private desires. An individualistic culture lacks the shared morality essential to nurturing civic virtue and thereby condemns humans to alienation, anomie, narcissism, decadence, and nihilism.

Strauss was also concerned about the impact of democracy on modern society. By permitting nearly all citizens to participate in the political process, democracy places ignorance and selfishness on an equal footing

with knowledge and virtue. Strauss worried that citizens in democratic societies are so preoccupied with the pursuit of narrow self-interest that they lack the ethical principles to respond wisely to broad issues affecting society as a whole.

Another aspect of the “crisis of modernity” is the tendency of science and technology to push aside morality. Liberal societies seek to resolve problems by gaining greater technical mastery over nature to better satisfy human desires. However, Strauss believed that the most fundamental problems facing modern societies are moral problems caused by the rejection of standards of right and wrong. The social sciences such as economics and political science cannot comprehend or respond to moral decline because their pretense of value neutrality and emphasis on quantitative technique blind them to moral issues. In Strauss’s words, social scientists are “fiddling while Rome burns.”

Strauss wanted government to be more than a neutral referee; it should act as a moral force in society by purposefully sustaining such values as patriotism, piety, and a sense of duty. Despite his qualms about democracy, Strauss acknowledged that no other political system provided safeguards against totalitarianism. Democracy could be made acceptable by limiting citizen participation in government so that leaders would not be subjected to the pressures of popular demands.

Michael Oakeshott (1901–1990)

A professor of political science at the London School of Economics, Michael Oakeshott, sought to make Conservatism appealing to the modern mind. Rejecting any reliance on religion or natural law, he simply claimed that existing customs and institutions are superior to experiments in social reform because they have slowly evolved in response to the accumulated wisdom of many generations.

In *Rationalism in Politics* (1962), Oakeshott blamed the expansion of government power on the rationalistic mentality that is the legacy of the Enlightenment. He criticized rationalism for seeking to impose an abstract, theoretical ideal on society to make it more fair and efficient. Rationalism is an unreliable guide because human reason can never fully comprehend the complexity of society and is usually critical of traditional authority, custom,

prejudice, and habit. Government efforts to rationalize society will inevitably disrupt the institutions guiding individual lives. As traditional institutions disintegrate, the competitive struggle between self-interested individuals leads to envy, jealousy, and resentment. This dissatisfaction with the status quo creates increasing demands on government to correct all perceived injustices and irrationalities.

Oakeshott valued tradition not only because it has withstood the test of time but also because it makes social restraints on individual choice seem natural and, therefore, largely invisible. Without tradition to guide the impulses of citizens toward socially useful goals, individuals resent any limitations on the gratification of their desires. In the absence of tradition, social conflicts cannot be resolved in a manner that is acceptable to opposing parties.

Despite his strong defense of tradition and authority, Oakeshott believed that individuals could enjoy a wide range of freedom without necessarily disrupting the social order. The key to making freedom compatible with order lies in the fact that humans form their personal identity by internalizing the culture in which they live. As a result of this socialization process, the range of choices that individuals actually make will usually be compatible with an orderly society. What Oakeshott opposed was the freedom of citizens to act collectively through government to restructure their society. In *On Human Conduct* (1975), he argued that society is not an “enterprise” with concrete goals such as full employment, the elimination of poverty, or social justice. Instead, society is a “moral association” having no concrete goals, but existing merely to provide a stable environment within which individuals discover meaning, purpose, and personal identity as they pursue their private goals.

According to Oakeshott, government should not be involved in economic affairs, and economic interests should not be permitted to influence government. If politics is permitted to degenerate into an arena of clashing private interests, then government will inevitably become coercive and arbitrary. Government should remain peripheral to the economy, acting merely to protect property and enforce the law. Unlike Classical Liberals, Oakeshott’s commitment to laissez-faire was not motivated by concerns about the inefficiency of government intervention. Rather, he believed that

government intervention disrupts the process by which traditional institutions make individual freedom compatible with social order.

PRINCIPLES OF CONSERVATISM

The essential tenets of Conservatism are summarized in the following definitions:

Human Nature. Humans are driven by strong passions that can be directed toward either evil or good. The human capacity for reason is limited, with some persons having greater rational powers than others. The manner in which instincts and desires are molded into a unique personality is a function of the roles played and associations formed with others. Humans cannot develop fully without the social relations provided by communities.

Society. Society is an organic structure based on a natural hierarchical order. The quality of society is a fundamental determinant of the interests and behavior of individuals. The good society sustains a stable hierarchy of social relations, which enables individuals to discover a unique role and identity for themselves. Without hierarchy, humans cannot distinguish themselves and the formation of individual personality is thwarted.

Government. The purpose of government is to maintain the natural order of society. During periods of social stability, government can simply uphold tradition and preserve existing institutions by serving as a visible symbol of the unity of the nation and by creating a moral climate conducive to the development of virtuous citizens. Government should not only enforce laws protecting property rights but should also actively nurture those institutions such as the family, the church, and neighborhood that provide a social context within which individuals develop.

Morality. Morality exists independently of individual opinions of right and wrong. Moral persons place higher priority on the pursuit of virtue than on the satisfaction of personal desires. Individual reason is an unreliable guide to morality because reason alone is not sufficiently powerful to override human passions. Only the emotional attachments and prejudices that arise from living within a stable and supportive community can guide

humans toward virtue. Moral values include loyalty, patriotism, chivalry, courage, deference to authority, and honor.

Freedom. Freedom exists when individuals are subject to neither arbitrary power nor their own passions. Freedom does not mean license to do whatever the individual desires. Since isolated individuals cannot gain control of their passions, freedom requires the authority, traditions, and order provided by a stable community.

Authority. Authority is legitimate when it resides with persons who fill traditional roles of leadership in society and who have knowledge of truth and virtue. Authority is essential for maintaining order and tradition in any social organization from the family to the nation.

Equality. People are equal only in their formal status as citizens deserving of equal protection under the law. Equality requires an impartial administration of justice in the protection of citizens' rights and punishment for their crimes.

Justice. Justice is fulfilled when the law is administered impartially. The notion of economic justice is meaningless since different societies accept different distributions of income and wealth.

Efficiency. Efficiency means that society functions smoothly in achieving not only material production but also nonmaterial goals such as the maintenance of order, culture, cohesive communities, and individual virtue.

CONSERVATISM TODAY

Although Classical Liberal economists are often called “conservative,” the notion of a Conservative economist is a bit of an oxymoron. Conservatives reject much of economic theory, claiming that its assumptions of individual autonomy and rational utility maximization are simply descriptions of the worst aspects of modern society—the alienation of the individual from social bonds and community values, the focus on material gratification of desires, and the elevation of profit making and efficiency as the guiding values for society. Economics, according to Conservatives, serves to justify acquisitive and selfish behavior, thereby undermining the cohesiveness and stability of communities. The ethic of

utility maximization legitimizes a materialistic lifestyle in which the consumption of commodities is the primary source of personal satisfaction.

In contrast to traditional economic theory, political economy can acknowledge the significance of community, traditional morality, history, and culture in determining the performance of an economic system. Conservative writers who believe that economic matters are too important to be left to liberal economists are now devoting considerable attention to political economy. Their analyses currently appear in a variety of forms, including Social Conservatism, Neoconservatism, and Paleoconservatism.

Social Conservatism

For Social Conservatives, economic and political issues are the manifestation of deeper moral and cultural problems. They view morality and traditional culture as the glue that holds society together by restraining self-interest, cultivating civic virtue, and sustaining communities within which individuals are able to find meaning and purpose in their lives. Social Conservatives often base their morality on religious beliefs derived from sacred texts such as the Bible. For those fundamentalists who strictly adhere to a literal interpretation of the Bible, right and wrong are clearly defined and any compromise with other viewpoints is unacceptable. Social Conservatives may even deny well-established scientific truths such as evolution and global climate change as contrary to scripture and, therefore, a threat to the foundation of all morality.

Social Conservatives view the path of social change since the Enlightenment as a continual erosion of religion, authority, culture, and community by the forces of individualism, secular humanism, materialism, and self-interest. Occasional spiritual revivals such as the periodic “Great Awakenings” in the United States during the 19th century have temporarily reversed the tides of history, but the trend toward moral and spiritual degeneration continues to the present. Social Conservatives compare modern-day culture in the United States to the biblical cities of Sodom and Gomorrah in which sin and evil prevailed.

The issues of greatest concern to Social Conservatives might seem to be unrelated to political economy. What connection do abortion, same-sex marriage, school prayer, and the teaching of evolution have with inflation,

unemployment, and poverty? For Social Conservatives, maintenance of the traditional definition of marriage, traditional gender roles, and the significance of religion in public life is essential to a successful economy. A spiritually impoverished nation cannot prosper economically. Unless children grow up in stable families and communities with clearly delineated gender roles and religious education, they will lack a moral basis for establishing a personal identity and making commitments to anything larger than themselves. In the absence of morality, individuals cannot develop the self-discipline required for economic success and instead aimlessly pursue immediate gratification. Social Conservatives view drug abuse as the logical culmination of liberalism's portrayal of humans as autonomous individuals engaged in the pursuit of pleasure.

While Social Conservatives profess allegiance to capitalism, freedom, and democracy, they reveal the links between Conservatism and authoritarian government by advocating restrictions on individual freedom such as laws prohibiting or restricting abortion, recreational drugs, prostitution, same-sex marriage, assisted suicide, embryonic stem cell research, pornography, immigration, and free trade with other nations. Taken to its extremes, Social Conservatism begins to resemble the nationalist, xenophobic, and racist fervor associated with fascism. Indeed, neo-Nazi groups such as the National Front in France, the Golden Dawn in Greece, and various far-right groups in the United States make the same appeals to traditional values and fear of foreigners as do Social Conservatives.

The tension between freedom and authority in Social Conservative thought can be understood by examining the meaning of freedom. For Social Conservatives, freedom does not imply a license to do whatever one wants. If that were the case, individuals would be controlled by their desires and impulses and therefore unfree. Genuine freedom requires moral integrity and self-restraint so that individuals choose to fulfill those desires consistent with their commitments, responsibilities, and obligations to others. Freedom is nourished by social institutions such as family, church, neighborhood, civic organizations, and local government. The autonomous, self-interested individual portrayed by liberalism and standard economic

theory threatens society by undermining families, religion, and communities.¹

Many of the most influential Social Conservatives, including Robert Nisbet (1913–1996), Allan Bloom (1930–1992), and Russell Kirk (1918–1994), are no longer alive, but the tradition continues with the writings of Patrick Buchanan, Robert Bork, and William Bennett. Social Conservative articles can be found in *The New American*, *The American Conservative*, and *Modern Age*.

Neoconservatism

Beginning in the late 1960s, a group of New York intellectuals created a new variant of Conservatism that came to be called Neoconservatism. Irving Kristol (1920–2009), Seymour Martin Lipset (1922–2006), and Norman Podhoretz had been Radicals during their youth, but were pushed toward Conservatism because of their disgust with the student counterculture of the 1960s, their dissatisfaction with the conciliatory nature of U.S. foreign policy toward the Soviet Union, and their disillusionment with the welfare state as a solution to poverty and crime.

Neoconservatives present themselves as not much different from Classical Liberals in their support for democracy, markets, and individual liberty. However, while Neoconservatives may appreciate the market's vitality and efficiency, they also fear its potential for undermining traditional values and culture. The market stimulates and unleashes individual desires for immediate gratification that conflict with the respect for authority, the work ethic, and the sense of moral responsibility required for an orderly society. Neoconservatives also reject the ethical relativism of Classical Liberalism, claiming that some values and lifestyles are superior to others. Finally, while Neoconservatives oppose many current government programs, they do defend a significant role for government in sustaining a social climate conducive to individual moral development and social cohesion.

Neoconservatives claim that an “adversary culture” or “new class” composed of professors, journalists, entertainers, social workers, health care professionals, and government bureaucrats has effectively captured control of public opinion by virtue of its visibility and influence on the media.

These groups are typically more liberal than the general population, and they use their power to build support for government spending on social programs from which they directly benefit as providers of health care, education, and other human services.

On economic issues, Neoconservatives support capitalism but accept the necessity of some government regulation and welfare programs in order to maintain social order. The issue on which Neoconservatives and Social Conservatives differ most sharply is foreign policy. Social Conservatives have historically been isolationists, opposing military intervention in other countries. Neoconservatives, in contrast, believe that the United States has a moral responsibility as well as a strong national interest in defending and propagating the ideals of constitutional government and capitalism around the world. They call for unilateral action by the U.S. government to engage in “nation-building” by employing military power and foreign aid to promote the spread of democratic capitalism.²

Neoconservatives were strong supporters of the U.S. involvement in Vietnam in the 1960s and continued to push for aggressive measures to combat the spread of communism in Central America and the Caribbean during the 1970s and 1980s. Shortly after the collapse of the Soviet Union in 1991, political scientist Samuel P. Huntington wrote a highly influential article claiming that Islamic fundamentalism would replace communism as the gravest threat to U.S. hegemony around the world.³ Since Saddam Hussein had been left in power after the Persian Gulf War of 1990–1991, Neoconservatives such as Paul Wolfowitz, Richard Perle, and Paul Bremer pushed for U.S. military intervention in Iraq to accomplish “regime change.” After the terrorist attack on the World Trade Center in 2001, Neoconservatives persuaded the Bush administration to launch a full-scale attack on Iraq in order to remove Hussein and establish a democratic government. The descent of Iraq into sectarian violence has diminished the credibility of Neoconservatives, but writers including Robert Kagan, Niall Ferguson, and William Kristol continue to present their ideas in journals such as *The Public Interest*, *The Weekly Standard*, *The National Interest*, and *Commentary*.

Paleoconservatism

Beginning in the 1980s, a reaction against Neoconservatism formed among some Conservative intellectuals. They adopted the term Paleoconservatism to indicate their return to fundamental principles that have guided Conservative thought since its inception in the late 18th century. However, unlike earlier Conservatives, Paleoconservatives do not defend the status quo. They claim that liberalism has become the dominant ideology in modern societies, and nothing short of an organized effort to change public opinion will reverse that trend. The resulting “culture wars” have centered around issues such as abortion, gun rights, affirmative action, same-sex marriage, religion in schools, multiculturalism, and immigration.

Like Social Conservatives, Paleoconservatives view moral and cultural decline as the cause of economic and political problems. They blame liberalism for fostering a self-interested, amoral citizenry more focused on individual pleasure than on commitments to family, community, nation, and religion. These larger institutions are the building blocks of society and, as they disintegrate, human existence is reduced to isolated individuals lacking meaning and purpose in their lives.

Paradoxically, Paleoconservatives link liberal individualism to authoritarian government. When individuals fail to learn morality and self-restraint within families, churches, and communities, they engage in antisocial activities and government becomes increasingly authoritarian in order to maintain law and order. Yet, by taking on increased responsibility for enforcing codes of conduct, governments “crowd out” local communities and institutions, thereby contributing to the disintegration of society. This self-reinforcing cycle pushes nations toward socialism or fascism as solutions to the chaos generated by liberal individualism.

In sharp contrast to Neoconservatives, Paleoconservatives oppose an aggressive U.S. foreign policy relying on military power to spread Western political and economic institutions. They accuse Neoconservatives of being Radicals in the sense of attempting to impose universal ideals such as freedom and democracy on other nations. Such efforts only destabilize traditional cultures and unleash sectarian strife. The culture of each nation is the result of centuries of gradual adaptation, and any sudden disruption, even if for noble purposes, creates disorder.

Paleoconservatives also oppose immigration, arguing that mixing together people from different cultures results in a bland, homogeneous

culture to which individuals feel no deep connection or commitment. Liberal values such as freedom and tolerance are designed to create a universal community, a “brotherhood of mankind,” but Paleoconservatives insist that such an abstract sense of community cannot meet the emotional needs of humans for a sense of belonging and attachment. People can only identify with particular communities based on, for example, religion, race, ethnicity, or region.

Acknowledging the importance of local communities, Paleoconservatives tend to oppose both big government and big business. They join with Radicals in criticizing the power of corporations to enrich themselves by crushing competitors and manipulating government. This “crony capitalism” is a perversion of the free enterprise system. Paleoconservatives also are more receptive to environmental concerns than are Classical Liberals. Whether for religious or secular reasons, they claim that mankind has a moral responsibility to act as stewards in protecting nature. Paleoconservatives also reject excessive consumerism and materialism as inconsistent with a stable and sustainable society.⁴ Paleoconservative ideas are presented in *The Intercollegiate Review* and *Chronicles: A Magazine of American Culture*. Among the leading advocates are Paul Gottfried, Thomas Fleming, and Roger Scruton.

AN ASSESSMENT OF CONSERVATISM

Conservatism has evolved over the past two centuries not so much because of changing fundamental principles but due to the evolving nature of the problems confronting modern societies. Early Conservatives blamed social disintegration and rootlessness on industrialization and opposed both liberal democracy and laissez-faire capitalism. By the end of the 19th century, however, a greater threat loomed on the horizon as socialism became an influential political ideal soon to materialize in Russia. The prospect of socialism gaining a foothold in Western nations caused Conservatives to suppress their concerns about capitalism. After witnessing socialism in Russia and fascism in Germany, Italy, and Japan, most

Conservatives conceded that capitalist democracy is the least evil of all feasible systems.

The fusion of Conservatism with Classical Liberalism in the post–World War II era entailed a synthesis of religious fundamentalism, support for free markets, and an aggressive foreign policy. The 1980 election of Ronald Reagan as president of the United States marked the ascendancy of this rightest coalition, but the underlying tensions between its component parts were never fully resolved. When the threat of global communism ended with the disintegration of the Soviet Union in 1991, Conservatives could finally express their long-suppressed differences with Classical Liberals. Conservatives fear that free-market capitalism, by rewarding materialism, self-interest, and the profit motive, tends to undermine traditional values and institutions essential to a stable and orderly society. Also, Conservatives are receptive to government as a mediator of social conflict and symbol of national unity. Conservatives believe that social order requires some repression of desires by the individual's own commitment to virtue, or by the social conditioning provided by community values and institutions, or, ultimately, by the threat of punishment from government. A capitalist economy, in contrast, fosters an ethic legitimizing the unbridled pursuit of pleasure. Conservatives seek to maintain the integrity of national cultures, while the market breeds cosmopolitan attitudes and lifestyles. Finally, Conservatives uphold a morality based on objective values, but the market makes the individual consumer the sole arbiter of values. The tension between the market and Conservative ideals explains the widening rift between Conservatives and Classical Liberals.

The Conservative critique of modern society highlights some of the shortcomings of capitalism. High material standards of living are accompanied by individual alienation, declining civic virtue, and diminished legitimacy of public institutions. Conservatives point to the number of young people who reject mainstream culture as evidence of an increasingly difficult struggle to find meaning and purpose in an amoral, commercialized society. The fact that many Conservative themes such as loss of meaning, alienation, and spiritual emptiness are also found in Radical critiques of capitalism illustrates the commitment shared by both perspectives to the importance of strong and vibrant communities. Indeed,

some Conservatives now join with Radicals in supporting environmental protection and social justice.

However, two major obstacles confront any significant increase in Conservative influence. First, Conservatism resists the two major trends in modern civilization: egalitarianism and individualism. These societal values, deeply embedded in Western culture, create widespread resistance to any proposals for strengthening hierarchical authority. Only an economic collapse or the threat of impending social chaos would open political space for the reassertion of authority.

Second, Conservatives have, for the most part, been unable to offer concrete proposals for generating cultural renewal without resorting to racism or national chauvinism. These values conflict with another powerful ideal in modern societies—the brotherhood of mankind. At a time when global economic integration is intensifying, appeals to parochial values and local culture do not generate wide support. Yet, this dilemma may point the way for the future of Conservatism. Rather than seeking to shape national or global policy, Conservatives might effectively pursue their ideals by focusing on family, neighborhood, and community revitalization.

NOTES

1. For more on Social Conservatism, see Jeffrey Bell, *The Case for Polarized Politics: Why America Needs Social Conservatism*. New York: Encounter Books, 2012; Robert H. Bork, *Slouching Towards Gomorrah: Modern Liberalism and the American Decline*. New York: HarperCollins, 2003; and Patrick J. Buchanan, *Day of Reckoning: How Hubris, Ideology, and Greed Are Tearing America Apart*. New York: St. Martin's, 1999.

2. Details of Neoconservatism can be found in Douglas Murray, *Neoconservatism: Why We Need It*. New York: Encounter Books, 2006; Justin Vaisse and Arthur Goldhammer, *Neoconservatism: The Biography of a Movement*. Cambridge, MA: Belknap Press, 2010; and Irwin Steltzer, *The Neocon Reader*. New York: Grove Press, 2004.

3. Samuel P. Huntington, "The Clash of Civilizations," *Foreign Affairs* 72(1993): 22–49.

4. Paleoconservatism is presented in Paul Edward Gottfried, *Conservatism in America: Making Sense of the American Right*. New York: Palgrave Macmillan, 2009; Joseph A. Scotchie, ed., *The Paleoconservatives: New Voices of the Old Right*. Piscataway, NJ: Transaction Publishers, 1999; and Roger Scruton, *How to Be a Conservative*. New York: Bloomsbury Press, 2014.

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Chapter 6

The Modern Liberal Perspective

The roots of Modern Liberalism lie deep in the tradition of Classical Liberalism. Although early Classical Liberal theorists such as John Locke and Adam Smith expressed reservations about the wisdom of relying solely on the market to organize society, their commitments to individual liberty and private property were sufficiently strong to preclude any significant action by government. With the emergence of Radical and Conservative challenges to free markets, however, laissez-faire policies became increasingly unpopular at the same time that the working class was gaining greater participation in the democratic political process. Recognizing this problem, some theorists developed an amalgam of elements from Classical Liberalism and Radicalism to form Modern Liberalism. The eclectic and hybrid nature of Modern Liberalism contributed to its political appeal as a wide spectrum of citizens were attracted by the prospect of promoting democracy and social justice within the context of a market economy. As a result, Modern Liberalism became the dominant ideology in the United States and Europe for much of the 20th century.

ARCHITECTS OF MODERN LIBERALISM

Jeremy Bentham (1748–1832)

The divergence of Modern Liberalism from Classical Liberalism began with English philosopher Jeremy Bentham's efforts to discredit the Lockean notions of natural law and natural rights. Bentham argued that Classical Liberal theorists used the term "natural" to defend their own particular vision of the good society. In an effort to develop a more scientific basis for social theory, Bentham developed a system of ethics known as utilitarianism. In *An Introduction to the Principles of Morals and Legislation* (1789), he claimed that pain and pleasure were the sole determinants of human behavior and the sole criteria of right and wrong. For an individual or for society as a whole, the best course of action is that which maximizes pleasure and minimizes pain. Although Bentham acknowledged the difficulty of measuring pleasure and calculating the precise consequences of any particular policy, he suggested that politicians should proceed as if such calculations could be made. Only then would political decisions be based on an objective assessment of their consequences.

Bentham's motive for replacing natural law with utilitarianism reflects the changing political environment of late 18th-century England. Classical Liberals had relied on the doctrines of natural law and natural rights to support their opposition to the arbitrary power of church and state. As that battle was being won, however, a new struggle between workers and owners of property began to develop. With the grounds of political conflict shifting, the doctrine of natural rights became unacceptable to defenders of private property for two reasons. First, Radicals such as Thomas Paine (1737–1809) used the concept of natural rights to defend workers' rights to participate in the political process. Among property owners, the prospect of extending the vote to workers raised fears of "mob rule" and a "tyranny of the majority" that might eventually result in confiscation of property. Second, the doctrine of natural rights offered such solid protection for property that it precluded government reforms aimed at ameliorating the conflict between workers and property owners. If property rights were absolutely inviolable, then government could not legitimately tax, regulate, or redistribute property. In short, natural rights served to protect the status quo, but increasing class conflict demonstrated that the status quo was unacceptable to a majority of the population.

In contrast to the doctrine of natural rights, utilitarianism provided a flexible and pragmatic basis for government intervention. Any reform resulting in favorable consequences for society as a whole was considered legitimate. Bentham claimed that rights were established by government, not by laws of nature. With new laws, government could legitimately create or eliminate certain property rights as long as the laws served the public interest. Cutting all ties to natural law and natural rights enabled Modern Liberalism to legitimize a wide array of government action.

On the controversial issue of whether government should engage in redistribution of income and wealth, Bentham equivocated. On one hand, utilitarianism provides a strong argument in favor of redistribution. The law of diminishing marginal utility suggests that wealthy individuals get less pleasure from a dollar than do poor individuals, and therefore, society's total utility could potentially be increased by redistributing money from rich to poor. Bentham affirmed this reasoning, stating that "the more nearly the actual proportion [of wealth] approaches equality, the greater will be the total mass of happiness." On the other hand, Bentham feared that redistribution would slow economic growth by undermining the security of property rights and reducing incentives for productive activity. He concluded that "when security and equality are in opposition, there should be no hesitation: equality should give way." Thus, while Bentham opened the door for extensive government activity, he tended to support laissez-faire policies in economic affairs. His proposals for reform were largely confined to the judiciary and penal systems, education, and the electoral process.

John Stuart Mill (1806–1873)

John Stuart Mill was one of the major intellectual figures of the 19th century. His father, James Mill, was also a prominent political economist and, along with Jeremy Bentham, decided to use his son as an experiment in rearing the ideal human being. The young boy was taught Greek and calculus before he was 10 and authored scholarly books while still a teenager. However, this rigorous intellectual training left John Stuart Mill emotionally unfulfilled, and he began reading the romantic writings of Samuel Taylor Coleridge and Thomas Carlyle to explore the nonintellectual

side of life. From that point on, Mill's work reflects an effort to steer a middle course between the calculating rationality of Bentham's utilitarianism and the romantic themes of spiritual introspection and emotional expression.

Mill affirmed the utilitarian guideline for organizing society in a manner that produces the greatest amount of pleasure. However, in contrast to Bentham, Mill introduced the idea of qualitative differences in pleasures. He believed that the pleasures associated with intellectual and artistic expression were superior to the pleasures of ownership or consumption. In his words, it is "better to be Socrates dissatisfied than a fool satisfied." Mill based his arguments for the superiority of certain types of pleasure on Aristotle's claim that the ultimate purpose of human life is to develop and exercise those capacities unique to the human species. For both Aristotle and Mill, these capacities included the ability to reason and to act consciously. Other activities such as eating, drinking, and procreating are functions common to all animals and, therefore, cannot be sources of ultimate human fulfillment.

The notion of a hierarchy of pleasures represents a challenge to the ethical relativism of Classical Liberalism. Modern Liberals now had a basis for making judgments concerning which lifestyles society ought to promote and hence a rationale for government intervention. However, Mill himself generally opposed legislative efforts to cultivate individual virtue. In *On Liberty* (1859), he argued that government should interfere with individual freedom only to prevent citizens from harming one another. Despite this dictum, Mill did support three specific forms of intervention: public funding for education, government encouragement of birth control, and an inheritance tax to offset the tendency for property holdings to become concentrated across generations.

Mill's efforts to synthesize the best of Classical Liberal, Conservative, and Radical ideas set the tone for the subsequent development of Modern Liberalism. Mill championed the cause of individual liberty and yet valued the role of "superior minds" in providing guidance and leadership for the rest of society. He supported universal suffrage, but only with the provision that educated citizens would have multiple votes so that their impact on the political process would be greater. In *Principles of Political Economy* (1848), Mill emphasized the importance of secure property rights in

fostering economic prosperity, yet he also favored experiments with cooperatives in hopes that they might eventually lead to a decentralized form of socialism.

Mill believed that both capitalism and democracy, while flawed, served essential functions. Capitalism facilitated the accumulation of wealth that would free humans from the drudgery of menial labor and permit them to focus on the higher pleasures of intellectual and artistic expression. Democracy, by permitting citizens to participate in society's collective decision making, gave citizens a sense of self-worth and dignity that, in turn, aroused their desire for more fulfilling lifestyles. Mill acknowledged that social change would take time, but government could hasten the process by providing public education and by promoting greater social equality.

Thomas Hill Green (1836–1882)

T. H. Green, an Oxford philosopher, sought to strike a balance between the individualism of Classical Liberalism and the romantic notion of community that had stimulated both Conservative and Radical thought. Green was concerned that Classical Liberalism, with its emphasis on protection of property rights and laissez-faire, could not appeal to workers. The English Reform Bill of 1867 extended suffrage rights to a broad spectrum of the working class, and if these new voters were to be peacefully integrated into the political process, government should take action to improve their living conditions.

Green supported many of the tenets of Classical Liberalism, including individual freedom, property rights, individual initiative, and self-reliance. However, he redefined certain principles to challenge the commitment to laissez-faire. Whereas Classical Liberals viewed humans as rationally pursuing maximum utility, Green claimed that humans do not seek utility directly, but rather strive to fulfill a self-image. In *Lectures on the Principles of Political Obligation* (1879), he argued that because these self-images are formed in a social environment, they reflect the shared values of a particular culture. Thus, the individual pursuit of utility will be restrained by a moral sensibility encompassing certain duties and obligations to others.

Green also revised the meaning of freedom. Whereas Classical Liberals focused exclusively on the absence of external constraint, Green defined freedom in a positive sense as the ability to effectively pursue a meaningful life. Positive freedom requires that individuals possess at least basic economic goods such as food and shelter. By expanding the meaning of freedom, Green was able to legitimize government efforts to relieve poverty and unemployment.

Finally, Green revised the basis of property rights. Classical Liberals claimed individuals possess a natural right to whatever assets are acquired without violating the rights of others. In contrast, Green claimed that property rights depend on society's recognition of their usefulness in promoting the public interest. In other words, rather than accepting the Classical Liberal view that the public interest is synonymous with the protection of property rights, Green argued that the public interest has an independent status prior to and determinative of property rights.

Although Green accepted the concept of private property in principle, he criticized the existing degree of inequality in property holdings. Excessive inequality interfered with the freedom of many workers who did not possess adequate resources to pursue meaningful lives. To determine the proper extent of government efforts to redistribute wealth, Green proposed that property rights should be evaluated according to their effect in promoting positive freedom. Those assets enabling individuals to exercise initiative, self-reliance, and innovation deserve to be protected. However, property rights that merely confer privilege and power over other persons pose a potential threat to positive freedom and, therefore, may legitimately be regulated by government. Green believed that through regulation and redistribution of property rights, government could release the individual initiative that was suppressed by poverty, thereby creating a dynamic economy in which every citizen had dignity and a decent standard of living.

Alfred Marshall (1842–1924)

As an economics professor at Cambridge University in England, Alfred Marshall developed much of the microeconomic theory that is taught in undergraduate courses today. Although Stanley Jevons was the first to suggest substituting the word “economics” for “political economy,” the title

of Marshall's textbook, *Principles of Economics* (1890), confirmed that the change in labels had gained acceptance. By rejecting the term "political economy," Marshall did not intend to exclude political or ethical considerations from public debate. Prior to becoming an economist, he studied ethics. Marshall was deeply concerned about the plight of the poor and believed that economics could provide guidance for government efforts to improve the quality of human existence. He was motivated to adopt the term "economics" instead of "political economy" by his desire to create a more scientific understanding of society. By limiting the scope of analysis to "that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of well-being," Marshall sought to focus on measurable phenomena that could be expressed in mathematical form. However, by defining economics more narrowly, he acknowledged the existence of noneconomic dimensions of life and noneconomic values that might also affect government policy making.

For many of Marshall's successors at Cambridge, the distinction between economics and political economy allowed economics to share the objectivity and rigor of the physical sciences, while political economy incorporated ethical considerations and permitted consideration of both economic and noneconomic goals. In sharp contrast, the Classical Liberalism of the Austrian school portrayed economics as covering the allocation of scarce resources to any goal, thereby making economics the "science of rational choice" and denying the existence of noneconomic values.

Marshall was quite cautious about any proposals for government intervention that would restrict economic freedom or violate property rights, claiming that freedom and security of property were essential to stimulate innovation, entrepreneurship, and economic growth. As a first line of attack against the problems of poverty and human suffering, Marshall hoped that individual citizens and businesses would engage in "economic chivalry" through public service and charitable contributions. However, he did recognize certain failings of the market economy, including unequal power in labor-management relations, the presence of negative externalities such as pollution, and the inability of the market to provide public goods such as universal education. Marshall expressed his acceptance of an active

role for government by noting that “the human will, guided by careful thought, can so modify circumstances as to [improve] the economic, as well as the moral, well-being of the masses of people.”

John Maynard Keynes (1883–1946)

As a professor of economics at Cambridge University, John Maynard Keynes was fully aware of the various flaws in the market uncovered by Marshall and Pigou. However, his condemnation of laissez-faire capitalism went far beyond previous criticisms. He blamed the “economic anarchy” of free markets for causing unemployment and excessive inequality in the distribution of income. In *The General Theory of Employment, Interest, and Money* (1936), Keynes attributed recessions to inadequate spending. This claim challenged the traditional wisdom of most economists who assumed that the main obstacle to growth was a lack of saving. Keynes argued that saving is beneficial only if the money is channeled back into the economy through borrowing and investment. When investors become pessimistic about the future, they hesitate to commit money to new projects, triggering a “multiplier effect” as the economy slows, workers lose their jobs, consumer spending drops, and businesses close.

Prior to Keynes, most economists viewed recessions as temporary aberrations requiring no government remedies. Keynes, in contrast, pointed to the Great Depression as evidence that the economy could sink into seemingly permanent stagnation. To the economists who argued that the economy would bounce back in the long run, Keynes replied: “In the long run we are all dead.” The cure for recession was increased government spending to supplement inadequate spending by consumers and businesses. Moreover, this government spending should be financed by borrowing rather than taxes since taxes reduce private spending. In calling for “deficit spending,” Keynes challenged the wisdom of generations of economists committed to balanced government budgets.

The Keynesian explanation of recessions also served to justify government efforts to redistribute income. Since low-income families spend a larger percentage of any additional income than do high-income families, government can increase private spending by shifting income from rich to poor. Whereas Bentham and Mill had been fearful that redistribution would

adversely affect incentives and capital accumulation, Keynes argued that greater equality would promote full employment and growth. Keynesian economics provided the rationale for government support of labor unions in their quest for higher wages.

Keynes attempted, without much success, to persuade Franklin Roosevelt to experiment with the new economics. Roosevelt remained skeptical, but World War II (WWII) forced the Western nations to engage in massive deficit spending, and the results seemed to confirm Keynesian theory. Factories quickly reopened, people went back to work, and the economy was operating at full employment within a short time after the Japanese bombing of Pearl Harbor. This success persuaded many economists and policy makers to change their view of the proper role of government and become Modern Liberals. As WWII ended, the United States Congress passed the Employment Act, committing government to pursue all practical means to maintain full employment.

John Rawls (1921–2002)

John Rawls was a Harvard philosopher whose book *A Theory of Justice* (1971) touched off an intensive re-examination of the ethical foundations of political economy. Rawls was responding to an emerging dilemma within Modern Liberalism. Although Modern Liberals had successfully challenged the inviolability of property rights and market-determined distributions of income, they lacked criteria for determining which property rights should be modified and the proper extent of income redistribution. Without a theory of the public interest or a theory of justice, Modern Liberal governments operated without principles, making them vulnerable to the pressures of special-interest groups. The political process was degenerating into a free-for-all in which more aggressive and powerful groups gained benefits from government at the expense of less powerful groups.

Faced with this dilemma, Rawls sought to define a particular distribution of income that could be defended as moral and, therefore, accepted as fair by all members of society. Achieving consensus on questions of fairness is normally impeded by the human tendency for self-interest to color our perceptions of justice. However, Rawls proposed a hypothetical “original position” in which individuals choose principles of justice without

knowledge of their own social status and particular interests. This procedure can be compared to a group of people who want to divide a cake fairly. The person cutting the cake gets the last slice in order to assure that self-interest will not affect the size of the slices.

If individuals had no knowledge of their own place in society, Rawls argued that two principles of justice would be chosen. First, each person would have the same basic liberties, and second, income and wealth would be distributed so as to maximize the well-being of the poorest members of society. The second principle is more controversial, but Rawls claimed that people lacking knowledge of their own interests would choose to protect the poorest group since they might be a member of that group. Rawls did not condemn self-interest but simply argued that people can be objective in formulating principles of justice only when they ignore the interests attached to their particular role in society.

Maximizing the well-being of the poorest groups in society does not imply perfect equality. Rawls recognized the role of inequality in providing incentives and fostering capital accumulation that ultimately benefits everyone. However, redistribution of wealth should proceed up to the point where any further transfers would so dampen incentives and growth that the poor would be harmed.

At first glance, Rawls's image of people suspending awareness of their own position in society seems highly implausible. However, he supported his theory by claiming that humans progress through stages of moral development. In the highest stage, actions are based on universal principles rather than on narrow self-interest. If the Rawlsian principles of justice would indeed be chosen by truly moral persons, then redistribution could be legitimized despite protests by those adversely affected. Rawls anticipated that protests would diminish as the experience of living in a fair society stimulated a moral sensibility, whereby individuals would value justice above their own material gains.

Rawls was the first Modern Liberal to offer a specific criterion of distributive justice. If accepted, the Rawlsian principles would put an end to many of the political struggles that have threatened to destroy the cohesiveness of modern societies. However, despite the widespread attention given to Rawls's ideas, his theory of justice has not been widely

embraced by Modern Liberals because it potentially mandates massive redistribution of wealth.

PRINCIPLES OF MODERN LIBERALISM

The following definitions convey the essential character of the Modern Liberal perspective.

Human Nature. Humans are capable of rational choice, but their goals are significantly shaped by their social environment. To develop fully, humans need social relations based on mutual respect, and this need creates moral sentiments that restrain pure selfishness.

Society. Society is an aggregation of individuals with both private and collective interests. Markets are well suited to fulfill private interests, but government action is needed to meet collective interests.

Government. The purpose of government is to impartially protect rights and to serve as a means by which citizens are able to collectively pursue goals unattainable through markets. Government should promote only those goals serving the public interest.

Morality. For the most part, values are subjective and therefore relative. However, certain values should have universal appeal, including respect for the rights and dignity of all persons, concern for the environment, and respect for the sovereignty of other nations.

Authority. Legitimate authority exists when power is exercised in the public interest. However, since Modern Liberalism offers no clear definition of the public interest, the distinction between legitimate and illegitimate authority remains an unresolved issue.

Freedom. Freedom has two meanings. In a negative sense, freedom is the absence of coercion or constraint imposed by other people or by government. In a positive sense, freedom is the ability to effectively pursue one's goals. These two conceptions of freedom may conflict with one another when the negative freedom of some persons poses an obstacle to the positive freedom of others.

Equality. Equality of opportunity and equality under the law are two important components of social equality. However, both are jeopardized by inequality of wealth and income, so greater equality of result is essential to achieving social equality.

Justice. Justice is achieved when both human rights and property rights are upheld. When these rights conflict, society, acting through government, should strive for a balance that best serves the public interest.

Efficiency. Efficiency means maximizing the value of goods and services produced. However, efficiency is only one criterion of a good society and may be superseded by considerations of freedom, equality, or justice.

MODERN LIBERALISM TODAY

WWII forced a dramatic expansion of the economic role of governments in most nations. The success of the war effort largely dispelled whatever doubts had lingered about the power of government to stimulate the economy. Nations that had been languishing in the Great Depression for a decade suddenly sprang to life, providing full employment and astonishing levels of output. When the war ended, there was no guarantee that depression would not return, and most governments took strong measures to guarantee continued prosperity. With Radicalism and Conservatism seemingly discredited by the horrors of Stalinist Russia and Nazi Germany and with Classical Liberalism largely discredited by the Great Depression, a consensus formed around Modern Liberalism that would dominate Western political economy for the next three decades. Currently, Modern Liberal ideas appear in various forms, including welfare economics, behavioral economics, and post-Keynesian economics.

Welfare Economics

Welfare economics is the branch of economics analyzing the effects of different institutions and policies on the overall welfare or well-being of society. During the 19th and early 20th centuries, economists supportive of laissez-faire policies often assumed that since a free market enables each individual to maximize utility subject to a budget constraint, the market

must also be efficient in the sense of generating maximum social welfare. However, the Italian economist Vilfredo Pareto rejected such claims as unscientific because they rested on the notion that individual utilities could be summed to arrive at social welfare. Pareto redefined efficiency as a situation in which no reallocation of resources can improve the well-being of one person without harming another.

During the 1930s, further advances in welfare economics by English economists John Hicks (1904–1989) and Nicholas Kaldor (1908–1986) demonstrated that economic efficiency typically fails to maximize social welfare. Given the current state of technology and consumer preferences, there are an infinite number of efficient allocations of resources corresponding to different patterns of resource ownership or “initial endowments.” Since the market caters only to those preferences backed by money, it will foster production of goods to satisfy trivial whims of the wealthy while neglecting basic needs of the poor. To determine which pattern of initial endowments would yield maximum social welfare requires value judgments concerning the relative merits of different human wants and needs. Hicks and Kaldor proposed that these value judgments could be based on a “social welfare function” derived through the political process. Once the social welfare function has been established, government would engage in redistribution (“lump-sum transfers”) to achieve the pattern of resource ownership maximizing social welfare.

In 1954, economists Kenneth Arrow and Gerard Debreu (1921–2004) elaborated on the work of Hicks and Kaldor by developing highly sophisticated mathematical proofs of two Fundamental Theorems of Welfare Economics. The first states that, under strict assumptions concerning perfect competition and complete markets, the market generates a Pareto efficient allocation of resources. The second claims that any desired efficient allocation can be attained by first establishing the appropriate pattern of resource ownership or initial endowments.

The implications of modern welfare economics pose a major challenge to Classical Liberal arguments for laissez-faire. The free market may be Pareto efficient, but this efficiency has no moral weight in assessing social welfare. Political deliberations over social justice take precedence over

market efficiency in shaping the good society. Property rights are no longer inviolable as redistribution may be required to maximize social welfare.¹

Behavioral Economics

In 1979, two psychologists, Daniel Kahneman (1934–) and Amos Tversky (1937–1996), published an article in a prestigious economics journal challenging economists' view of human behavior.² Neoclassical economic theory is built on the assumption that humans rely on rational calculations of self-interest in order to maximize profit or utility. Yet, the real world is rife with examples of bad choices and irrational behavior. The article by Kahneman and Tversky launched a new field of inquiry called behavioral economics, in which the insights provided by psychology and economics are integrated. Humans are certainly capable of making rational choices at times, but their choices are often “predictably irrational.”

Behavioral economists have confirmed a variety of types of “irrational” behavior. Individuals often rely on habits or rules of thumb rather than making careful calculations of the costs and benefits associated with a decision. In addition, some people may lack self-control or have conflicting desires so that their current choices are incongruent with long-term goals. Moreover, the way in which an option is presented or “framed” can affect individual choice. For example, if employees have the option to place money in a retirement plan, many will procrastinate and fail to enroll. In contrast, if they are automatically enrolled unless they opt out, the participation rate is much higher despite the fact that employees are free to choose either option in both cases. The meat-packing industry relies on the “framing effect” when it labels ground beef as 80 percent lean rather than 20 percent fat.

Research by behavioral economists reveals that humans tend to overestimate the probability of rare events and underestimate the probability of common events. For example, people worry more about terrorist attacks than about automobile accidents despite the fact that the latter are much more frequent. Humans also exhibit an “optimism bias” leading to overconfidence in their chances of success. The combination of overestimating the likelihood of rare events and optimism bias explains the popularity of lottery tickets.

Perhaps the most significant human trait confirmed by experiments in behavioral economics is a willingness to sacrifice individual utility for the sake of fairness or justice. In a so-called ultimatum game, researchers pair two individuals and give one of them \$10. That person is instructed to offer part of the money to his or her partner with the understanding that if the partner rejects the offer, neither will get to keep any money. Standard economic theory would suggest that any offer above zero would be accepted because some money is better than none. However, partners consistently reject offers deemed to be unfairly low, indicating a willingness to sacrifice money in order to punish a perceived injustice.

Behavioral economics is situated within the Modern Liberal perspective because it implies that social justice is valued by citizens who are willing to sacrifice in order to achieve that goal. Behavioral economics also demonstrates that individual behavior can be changed through appropriate government policies. In many cases, these policies may simply consist of a “nudge” to make one choice rather than another by framing the options differently. As an example, if all employees were automatically enrolled in retirement savings plans with the choice to opt out, more saving would occur and the financial difficulties facing many senior citizens would be eased. Among the most prominent behavioral economists are Dan Ariely, Richard Thaler, and Robert Schiller.³ Articles on behavioral economics can be found in the *Journal of Behavioral Economics*, the *Journal of Behavioral and Experimental Economics*, the *International Journal of Applied Behavioral Economics*, and the *Journal of Economic Behavior and Organization*.

Post-Keynesian Economics

The economist most responsible for popularizing Keynesian economics in the United States was Paul Samuelson (1915–2009). He proposed a “neoclassical synthesis” in which neoclassical microeconomics would retain its validity for analyzing the choices of individuals and firms, while Keynesian macroeconomics explained the functioning of the economic system as a whole. According to Samuelson, if Keynesian fiscal and monetary policies were used to “fine-tune” the economy by adjusting aggregate demand to maintain full employment, the free market would

perform its function of allocating resources efficiently. Keynes died in 1946, so he was unavailable to render judgment on the accuracy of Samuelson's interpretation of his ideas. However, several of Keynes's colleagues at Cambridge University in England claimed that Samuelson had ignored many of the fundamental points of Keynesian economics. Under the leadership of Joan Robinson (1903–1983) and Polish economist Michal Kalecki (1899–1970), they initiated a new school of thought called post-Keynesian economics in order to revive and, in some cases, modify Keynes's original work. Other important early contributors from England included Piero Sraffa (1898–1983), Maurice Dobb (1900–1976), and Nicholas Kaldor (1908–1986). In the United States, prominent figures in the development of post-Keynesian economics included Sidney Weintraub (1914–1983), Alfred Eichner (1937–1988), and Hyman Minsky (1919–1996).

Post-Keynesian economics should not be confused with New Keynesian economics. The latter developed during the 1980s in response to the failure of Keynesian policies to combat stagflation. New Keynesian economists largely accept neoclassical microeconomics and seek to demonstrate the “microfoundations” of unemployment and inflation. They attribute macroeconomic instability to lack of competition and “rigidities” in markets that prevent prices and wages from moving toward equilibrium levels. For example, wages may be “sticky” due to union contracts, minimum wage laws, and resistance among workers to wage cuts.

In contrast, post-Keynesian economists view neoclassical microeconomics as largely irrelevant in explaining inflation and unemployment. Like Keynes, they believe that a market economy is inherently unstable due to uncertainty caused by lack of information. Uncertainty prevents investors from accurately assessing risk and leads to “herd behavior” as market participants become overly optimistic during booms and overly pessimistic during recessions. Hyman Minsky argued that periods of strong economic growth cause the financial system to become increasingly prone to crisis as investors take on excessive risk and lenders extend excessive credit.

Keynes called for two major reforms: government action to regulate aggregate spending and government control or “socialization” of investment. Policy makers in the United States adopted the first reform but

ignored the second because it requires more extensive government management of the economy. Yet, without some degree of public control over investment, post-Keynesians believe that government cannot maintain both price stability and low unemployment for extended periods. Socialization of investment might take the form of government subsidies or taxes to stimulate or discourage investment depending on the state of the economy. Alternatively, government could use tax revenue to invest in infrastructure such as highways, public transport, education, or research and development.

Post-Keynesians acknowledge that traditional Keynesian fiscal and monetary policies have been rendered ineffective by the increasing concentration of production. In the absence of effective competition, large corporations possess “market power” and engage in “cost-plus pricing” by simply adding a desired profit margin to their costs in order to set the price of their product. In this context, governmental efforts to control inflation are stymied. When government reduces spending or tightens the money supply, businesses simply lay off workers and reduce output rather than lower their prices. The result is stagflation—simultaneous inflation and unemployment.

The Great Recession of 2008 led to a renaissance of Keynesian and post-Keynesian economics. Like the Great Depression of the 1930s, the global economy sank into an “underemployment equilibrium” in which lack of jobs constrained consumer spending and inadequate spending discouraged businesses from creating new jobs. While most European nations responded to the crisis with “austerity” programs of reduced government spending and tight monetary policy, the United States followed the Keynesian route with massive fiscal stimulus and money creation. The relative health of the U.S. economy in the aftermath of the Great Recession has revived the credibility of the Keynesian approach.

To maintain strong economic growth, post-Keynesians advocate government action to maintain near-full employment either by subsidizing private employers to increase hiring or by making the government the “employer of last resort.” In the past, full employment would have inevitably created inflationary pressures, but increased global competition now discourages corporations and labor unions from raising prices and wages. Post-Keynesians also propose to reduce the volatility of financial

markets through increased regulation.⁴ Prominent contemporary post-Keynesians include John Eatwell, Marc Lavoie, and Jan Kregel. Post-Keynesian ideas are featured in the *Journal of Post Keynesian Economics*, the *Cambridge Journal of Economics*, and the *Review of Keynesian Economics*.

AN ASSESSMENT OF MODERN LIBERALISM

Modern Liberalism was the dominant ideology in Western nations from the Great Depression of the 1930s until the 1970s. Its appeal stemmed not only from the success of Keynesian economics in maintaining prosperity during that period but also from the postwar revulsion toward any pure form of ideology. Modern Liberalism offered a flexible and pragmatic approach well suited to the public's growing acceptance of a "mixed economy," in which an active government would improve and supplement the functioning of a market economy.

Beginning in the late 1960s, the dominance of Modern Liberalism was challenged, first by the Radicals of the New Left, then by a resurgence of Classical Liberalism in the 1970s, and eventually by a reenergized Conservatism in the 1990s. Radicals faulted the Modern Liberal commitment to private property and markets for suppressing efforts to promote social justice, improved democracy, and environmental protection. Classical Liberals attacked from the opposite side, blaming Modern Liberals for impeding growth and prosperity by undermining property rights and regulating markets in the pursuit of social justice. Conservatives joined the fray, charging Modern Liberalism with the destruction of traditional morality and communities. Yet, despite the intensity of these ideological battles, Modern Liberalism survives as a major ideological force in most developed nations.

The difficulties confronting Modern Liberalism are attributable to four factors. First, in the context of slower growth rates and high unemployment, Modern Liberal efforts to aid disadvantaged groups are increasingly perceived as coming at the expense of other citizens. Economist Lester

Thurow coined the term “zero-sum society” to describe a no-growth economy in which one group’s gain is another group’s loss.⁵ In a zero-sum society, redistributive policies are likely to create resentment and anger, thereby eroding public support for Modern Liberalism.

Second, Modern Liberalism’s emphasis on universal values such as justice and human rights often conflicts with citizens’ attachments to particular values and cultures. On issues ranging from welfare to criminal justice, Modern Liberalism is widely perceived as defending abstract rights while remaining insensitive to the wishes and interests of particular individuals or groups. For this reason, critics blame Modern Liberalism for a decline of moral standards and disintegration of traditional cultures.

Third, globalization of economic activity has created strong competitive pressures on all nations to dismantle any regulations or institutions that raise production costs for domestic businesses. The quest to attract new businesses and investment motivates governments to ease environmental regulations, relax the enforcement of antitrust laws, weaken labor unions, cut taxes, and remove restrictions on the flow of financial capital across national borders.

Finally, because Modern Liberalism encompasses values taken from conflicting ideologies, it lacks a clear and coherent vision of the public interest and, therefore, possesses no firm criteria by which to assess the performance of either the market or government. The Modern Liberal commitment to individualism makes individual preferences the ultimate source of social values; yet, Modern Liberalism is also committed to ideals such as social justice, even if that goal requires manipulation of the market economy by government. Once the beneficence of the market has been challenged, some criterion of justice or the public interest is needed to provide direction and coherence to government activities.

In attempting to resolve this dilemma, Modern Liberals face a choice. They can simply accept the absence of a theory of justice, leaving both the market and government without firm moral legitimacy, or they can formulate specific principles of justice to clearly define the public interest. To choose the latter route, however, would commit Modern Liberals to government action aimed at bringing society into conformance with the principles of justice. Most Modern Liberals remain too firmly committed to

the notions of ethical relativism, pluralism, diversity, and tolerance to support any precise definition of justice that would legitimize such a powerful role for government.

For those who find Conservatism, Classical Liberalism, and Radicalism to be unacceptable, the synthetic and compromising nature of Modern Liberalism will continue to hold appeal. Proponents of Modern Liberalism offer no ultimate resolution of the conflicts between human rights and property rights, between freedom and equality, or between individualism and community, claiming that these tensions between opposing ideals are irreducible features of human existence.

NOTES

1. For more on welfare economics, see I. M. D. Little, *A Critique of Welfare Economics*. Oxford: Oxford University Press, 1950; Francis M. Bator, “The Simple Analytics of Welfare Maximization,” *American Economic Review* 47(1957): 22–59; and E. J. Mishan, *Economic Efficiency and Social Welfare: Selected Essays on the Fundamental Aspects of Social Welfare*, reprint edition. New York: Routledge, 2012.

2. Daniel Kahneman and Amos Tversky, “Prospect Theory: An Analysis of Decisions under Risk,” *Econometrica* 47(1979): 263–291.

3. Additional details on behavioral economics can be found in Richard H. Thaler, *Misbehaving: The Making of Behavioral Economics*. New York: W. W. Norton, 2015; Daniel Ariely, *Predictably Irrational: The Hidden Forces That Shape Our Decisions*. New York: HarperCollins, 2008; and Peter Diamond, *Behavioral Economics and Its Application*. Princeton, NJ: Princeton University Press, 2007.

4. Post-Keynesian economics is presented in J. E. King, *A History of Post-Keynesian Economics since 1936*. Northampton, MA: Edward Elgar, 2004; Paul Davidson, *Post Keynesian Macroeconomic Theory: A Foundation for Successful Economic Policy for the Twenty-First Century*, 2nd ed. Northampton, MA: Edward Elgar, 2011; and Marc LaVoie, *Post-Keynesian Economics: New Foundations*. Northampton, MA: Edward Elgar, 2015.

5. Lester Thurow, *The Zero-Sum Society: Distribution and the Possibilities for Change*, reprint edition. New York: Basic Books, 2001.

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PART III

CONTEMPORARY ISSUES IN POLITICAL ECONOMY

Chapter 7

Government and the Market

During the first half of the 20th century, the combination of two world wars and the Great Depression served as a catalyst for expanding the role of government. Public reaction to this transformation remained generally favorable up to the late 1960s. Since that time, many citizens have become increasingly cynical and hostile toward government. Politicians now frequently campaign for public office as “outsiders” promising to repair the damage caused by previous administrations. Public apathy is reflected in low voter turnouts and a relative lack of interest or participation in political affairs.

The post–World War II (WWII) consensus favoring a “mixed economy” with an active role for government in improving the performance of a market economy has split along increasingly polarized ideological lines. Classical Liberals and Conservatives remain determined to roll back the functions of government, while Modern Liberals and Radicals advocate enlarged authority for the public sector. Yet, despite the rancor with which these disputes are conducted, all sides support the fundamental principles of democracy along with the rule of law, protection of rights, and provision of essential public goods.

In this chapter, we confront basic questions about democracy and capitalism. What is government’s proper role in a market economy? What

aspects of modern society prevent government from serving its proper role and what changes might remedy these shortcomings? Different responses emerge from each of the four ideological perspectives.

THE CLASSICAL LIBERAL PERSPECTIVE

The Proper Role of Government The Classical Liberal view of government is succinctly expressed by Thomas Jefferson's famous dictum: "that government is best which governs the least." Classical Liberals believe that the economy and society will function smoothly as long as government serves merely as a "referee" or "night watchman," enacting and enforcing laws that protect private property and the civil rights shared by all citizens. In addition, most Classical Liberals accept the necessity of some regulations and government provision of public goods, but they insist on strict constitutional limits on the scope of government authority. The functions of good government are to protect rights, provide only essential public goods and regulations, and adhere to constitutional constraints.

1. *Protecting rights.* Property rights actually encompass a bundle of rights. Owners of property have rights to (1) use property in any manner consistent with the law, (2) dispose of property by selling, gifting, or destroying it, (3) exclude others from using their property, and (4) earn income by engaging property in productive activity. Classical Liberals view secure property rights as a prerequisite to social stability and economic prosperity, so they support the role of government in establishing a legal system consisting of laws, police, courts, and prisons to prevent violations of property rights.¹ Without well-defined and secure property rights, individuals would have little incentive to invest in productive assets because they could not be assured of reaping the rewards of their efforts.

Classical Liberals also defend a role for government in protecting civil rights such as those codified in the United States Bill of Rights. Individual liberty would be violated without rights to free speech and a free press, to

privacy, to bear arms, and to worship freely. Since the exercise of these rights requires no direct provision of resources by government, the only role for government in protecting civil rights is to prevent or halt violations. Classical Liberals object to any extension of civil rights that might entitle individuals to income or resources. For example, in 1944, President Franklin Roosevelt proposed an economic bill of rights granting each citizen a right to a job, a home, medical care, education, and insurance against sickness, accident, or disability. Classical Liberals defeated this proposal, claiming that funding such “entitlements” would require a redistribution of income. Redistribution not only violates property rights but also reduces the incentives for productive activity and undermines individual responsibility.

2. *Minimal public goods.* While Adam Smith is associated with the term “laissez-faire,” he acknowledged the need for government to provide currency, to establish a legal system, to provide certain public goods such as national defense, harbors, and roads, and to tax citizens to gain the revenue necessary to conduct these functions. However, other Classical Liberals, particularly those inclined toward libertarianism, often object to government provision of public goods as both unnecessary and counterproductive. Friedrich Hayek claimed that a government monopoly on the printing of currency leads to excessive creation of money and a consequent loss of its value. He proposed a system in which several private firms would be commissioned to issue different currencies. Competition to promote the use of each currency would provide a strong incentive for each firm to limit money creation because citizens would use the currency that maintained its value over time.

Classical Liberals argue that most of the goods and services currently provided by government could be better supplied by private firms. Government provision has perverse effects by discouraging private businesses from entering certain markets and, in some cases, by exacerbating problems. For example, the availability of public education reduces demand for private schools, social security benefits reduce the incentives for individuals to save for retirement, and welfare programs can cause citizens to contribute less to private charities.

Even the authority of the government to tax beyond a minimal level is controversial among Classical Liberals. While democracy would seem to provide a bulwark against excessive taxation by giving voters the ability to remove politicians from office, Classical Liberals fear that politicians will, in effect, “buy votes” by using tax revenue to provide benefits to the electorate. Those receiving the benefits usually continue to re-elect their representatives, and many voters are either uninformed or apathetic. Since the concept of private property includes a right to the earnings generated by one’s productive assets, Classical Liberals often portray taxation as theft, in which citizens are deprived of their rightful earnings by the coercive power of government.

3. *Minimal regulation.* Many government regulations have been created to address so-called market failures, wherein the free market fails to achieve efficiency. Classical Liberals challenge the very concept of market failure, arguing that many of the shortcomings of the market actually result from government intervention.² They attribute the market power of large corporations to government-imposed barriers to competition such as regulations and tariffs. Much of the instability of the economy, they claim, is caused by government’s use of monetary and fiscal policy to manipulate the level of economic activity. Unemployment is caused by government-protected labor unions, minimum wage laws, and welfare programs.

Even if the market does exhibit shortcomings, Classical Liberals argue that government action to correct those flaws often creates unintended consequences that make matters worse.³ To rebut the concept of “market failure,” Classical Liberals use the term “government failure” to describe what they view as the inherent weaknesses of government and its inability to improve market outcomes.⁴ Government intervention not only disrupts efficiency but also violates individual freedom. Citizens are the best judges of their own well-being and should be free to express their choices in the market.

4. *Constitutional democracy.* While Classical Liberals support democracy in principle, they worry that citizens will vote for candidates promising to use the power of government to deliver benefits to particular

groups at the expense of others. To ensure that government does not favor some individuals over others by redistributing income or by manipulating the market, Classical Liberals rely on a constitution to restrict governmental authority.⁵ Classical Liberals distrust politicians and believe that voters will pressure government to expand its functions unless a constitution strictly circumscribes the scope of governmental authority. Any government free to exercise its power, or any democracy in which all laws and rights are subject to majority rule, will inevitably become oppressive.

The Actual Role of Government From the Classical Liberal perspective, government in modern societies neither promotes the public interest nor serves as benevolent guardian protecting the rights of all citizens. Government acts more as a predatory oppressor, extorting money from citizens and restricting their freedom. Powerful interest groups use government to secure privileges and extract wealth from fellow citizens. Government is inherently inefficient, squandering resources while providing goods and services that, for the most part, are either unnecessary or could have been produced in the private sector at lower cost.

The Classical Liberal analysis of government is called “public choice theory.” Pioneered during the 1960s by Anthony Downs, James Buchanan (1919–2013), and Gordon Tullock (1922–2014), this theoretical approach consists of the application of neoclassical economic analysis to the political process.⁶ Public choice theory assumes that the self-interested, maximizing behavior attributed to individuals in the market applies as well to political activity. Unless constitutional constraints on the boundaries of politics are strictly maintained, the pressures created by individuals and groups attempting to advance their self-interest through the political process will result in continual growth of government and a corresponding threat to both liberty and efficiency. Public choice theorists expect individuals and groups to use any means available to attain their goals, but they blame the judiciary branch of government, particularly the Supreme Court, for failing to adhere to the “original intent” of the framers of the Constitution to minimize the role of government. From the Classical Liberal perspective, the proliferation of new laws, regulations, and public policies reaches far

beyond constitutional limitations on the scope of government. Public choice theory focuses on three aspects of the political process: the behavior of interest groups, the behavior of politicians and bureaucrats, and the behavior of voters.

1. *Interest groups*. Public choice theorists use the term “rent-seeking” to describe efforts by individuals, businesses, and groups to increase their income by using the regulatory power of government to manipulate the market.⁷ Economists define rent as income accruing to a factor of production in excess of what that factor could earn in its best alternative use in a competitive market. Rent arises when the supply of a particular resource is limited so that a higher price does not elicit an increase in the quantity of the resource supplied. An example of economic rent is the high salaries earned by professional athletes due to their rare physical skills.

Businesses and individuals gain rent when they use the power of government to restrict the supply of, or increase the demand for, the resources they own. Economist George Stigler (1911–1991) claimed that government regulation is often initiated by businesses seeking protection from competition. If this is true, then regulations will likely serve the interests of the affected industries rather than the public interest. Stigler argued that government agencies with responsibility for regulation have been captured by the very industries they are intended to regulate.⁸

Regulations may benefit businesses by mandating the purchase of a particular product or by restricting entry into an industry. For example, licensing requirements in occupations ranging from physicians to hair stylists limit entry and, therefore, protect the income of those already in practice. Government protection of labor unions promotes higher incomes for union members. Zoning laws protect property values in particular neighborhoods. By increasing the cost of doing business, regulations may actually benefit large corporations by driving smaller firms out of the market and discouraging the entry of new competitors.

Rent-seeking undermines both the efficiency of the market and the functioning of government. Government is confronted with ever-increasing demands for benefits, as citizens look to the political process for economic gains that should be attainable only through the market. The high tax rates

required to meet the demands of rent-seekers discourage productive activity and, therefore, reduce the tax base from which government derives its revenue. High tax rates also lead to greater tax avoidance and evasion as individuals and firms try to protect themselves against the power of government to seize their income for the benefit of special-interest groups. Moreover, the growing perception that lobbying and political organizing are more rewarding than market activity causes a diversion of resources away from production toward lobbying and a resulting erosion of efficiency in the private sector.

To explain why interest groups proliferate in a democratic political system not firmly constrained by a constitution, public choice theorists argue that the benefits of any particular government program are often concentrated on a small segment of the population while the costs are dispersed among all taxpayers. This imbalance gives interest groups a strong incentive to organize and lobby in favor of particular programs. Taxpayers are less motivated to resist these programs because the additional tax burden to an individual for any single program is usually quite small.⁹

2. *Bureaucrats and politicians.* Public choice theorists also attribute the expansion of government to the self-interest of government employees. Bureaucrats become “empire builders” because a larger agency offers greater opportunities for career advancement, more funding, wider recognition, and expanded power. After a bureaucratic agency reaches a certain size, it can essentially perpetuate itself by creating a large constituency of employees, clients, and other beneficiaries who will resist any efforts to reduce funding.

As for elected politicians, public choice theory portrays them as “political entrepreneurs” who have entered politics anticipating high rewards in terms of remuneration, social status, and power. To explain why legislation benefitting only special interest groups is often approved, public choice theorists point to the practice of “logrolling.” Politicians form coalitions within which they agree to vote for the favored legislation of other politicians in return for the promise of reciprocal support. As a result, many bills are passed that would otherwise fail to gain majority support and government continues to expand.

Classical Liberals claim that politicians suffer from “rational myopia.” In their quest for reelection, politicians focus on providing short-term benefits to their constituents while ignoring long-term consequences. This mindset contributes to budget deficits as politicians endeavor to provide maximum government benefits without raising taxes. By borrowing instead of taxing, government shifts the costs of programs onto future generations who will not be voting in the next election.¹⁰

3. *Voters.* If citizens are purely self-interested, then why would they bother to vote? Voting requires time and effort, yet a single vote will, in all likelihood, have no impact on the outcome of any election. A rational person, after weighing the costs and benefits of voting, would seemingly choose not to vote. Similarly, citizens might be expected to remain “rationally ignorant” about political affairs.¹¹ Becoming a well-informed citizen takes time and effort, and since this knowledge is unlikely to benefit individuals in terms of influencing the outcome of an election, citizens would seemingly have no incentive to acquire sufficient information to vote wisely.

These arguments lead Classical Liberals to express concerns about democracy.¹² Citizens willing to incur the costs of becoming informed and voting are likely to be those who stand to gain from a particular government program, so democracy contains a built-in bias favoring the expansion of government. Other Classical Liberal concerns about democracy include the claim that voting is an imprecise method for registering individual preferences since elections occur infrequently, citizens are not permitted to vote separately on each policy, and voters have little discretion over the quantity or quality of public goods. Classical Liberals argue that government will normally provide too many public goods because a majority of voters can force the minority to share the burden of financing public goods.

Proposals for Political Reform 1. *Lower taxes.* From the Classical Liberal perspective, any taxation beyond the level required to fund government’s basic functions is illegitimate and damaging to the economy. Particularly harmful is the progressive income tax that, by

imposing a disproportionate burden on high-income households, depletes the pool of savings that is the source of funds for investment. More generally, any tax on income reduces the incentives for productive activity and slows the economy. If a tax on income is necessary to generate sufficient government revenue, Classical Liberals propose a “flat tax” that takes the same percentage from all households regardless of income level. They also favor less reliance on an income tax by instead taxing consumption through a value-added tax or by imposing a poll tax requiring each person to pay the same dollar amount.

Classical Liberals disagree among themselves over the effect of tax cuts on government budget deficits. Those calling themselves “supply-siders” attempt to allay fears of rising deficits by arguing that reduced tax rates will stimulate economic activity sufficiently to generate greater tax revenue and reduce the budget deficit. Other Classical Liberals accept that tax cuts may temporarily enlarge the deficit but anticipate that growing deficits will eventually force the government to reduce its spending. Tax cuts will “starve the beast” by cutting off the lifeblood that fuels government expansion.

2. *Less government spending.* Classical Liberals favor substantial reductions in the size of government and the scope of its authority. They encourage the enactment of “sunset laws” mandating the expiration of any government program not renewed by the legislature each year. Classical Liberals also call for a constitutional amendment requiring a balanced government budget annually. High on the list of Classical Liberal priorities for budget cuts are “entitlement programs” such as public assistance, Medicaid, and social security. These programs swell the budget deficit and redistribute income, thereby reducing incentives for productive activity. Another favorite target for reductions in government spending is the funding for regulatory agencies such as the Occupational Safety and Health Administration or the National Labor Relations Board.

3. *Deregulation.* Classical Liberals argue that many government regulations result from rent-seeking by special interest groups. Corporations and labor unions welcome regulations that suppress competition by creating

barriers to entry. Government bureaucrats favor expanded regulation in order to enlarge their budgets and power. Because regulations often do not serve the public interest, they can be eliminated with no adverse consequences. The benefits of reduced regulation include lower business costs, more competition, improved efficiency, and lower consumer prices.

4. *Privatization.* Classical Liberals view government as inherently inefficient in providing goods and services since it faces no competition and has no fixed constraint on spending. At the very least, Classical Liberals would permit private firms to compete with government agencies to determine how social services and public goods can be provided at the lowest cost. Classical Liberals predict that such experiments would demonstrate the superiority of private enterprise and lead to the eventual privatization of many of the activities currently performed by government.¹³ Recent experiments with privatization include private jails, private courts and judges, private education, and private police forces. Those government programs dealing with income maintenance and social security could be privatized through mandatory contributions to pensions or insurance policies to protect citizens against loss of income associated with unemployment, illness, disability, or old age.

5. *Originalism.* The U.S. Constitution states that “the powers not delegated [to the Federal government] by this constitution are reserved to the States.” The Constitution does not grant the Federal government the power, for example, to collect an income tax, regulate interstate commerce, or use monetary and fiscal policy to stabilize the economy. Later court decisions have legitimized these powers by viewing the Constitution as a “living document” subject to continual reinterpretation in order to remain relevant to current conditions. Classical Liberals call for the appointment of Supreme Court justices who will practice “originalism” by adhering to the original intent of the framers of the Constitution and eliminating the vast array of government programs currently regulating economic activity and redistributing income.

In an effort to develop a constitutional basis for minimal government, Classical Liberals have been instrumental in developing a subdiscipline

called “law and economics,” in which neoclassical economic theory is applied to the legal system. According to Richard Posner and Richard Epstein, the overriding purpose of law should be to promote economic efficiency and maximize the creation of wealth.¹⁴ High on their list of proposed changes is tort reform to reduce the penalties paid by corporations found guilty of negligence. They claim that court judgments or settlements requiring corporations to pay large sums of money to plaintiffs effectively reduce investments that would otherwise have led to job creation and technological advances.

Classical Liberals argue that many government regulations and taxes violate the U.S. Constitution and therefore should be eliminated. The Fifth Amendment to the Constitution prohibits government from taking private property without “just compensation.” Classical Liberals interpret this “takings clause” to mean that government must compensate businesses for any lost profits caused by regulations. They anticipate that if government were required to fully compensate businesses for lost profits, taxpayers would vote to reduce regulations. Classical Liberals also would like to abolish the redistributive function of government by revising tax laws to assure that each citizen’s taxes do not exceed the value of government benefits received.

6. *Constitutional amendments.* Although Classical Liberals insist on a strict interpretation of the Constitution, that document permits amendments subject to approval by three-fourths of the state legislatures. Examples of amendments proposed by Classical Liberals include requirements that the government balance its budget every year, that all appropriations of public funds be subject to a two-thirds voting rule, that the Federal Reserve maintain a fixed rate of monetary growth, that the progressive income tax be replaced with a flat tax, and that government spending be limited to no more than 25 percent of GDP. Classical Liberals warn that if the size and scope of government are not significantly reduced, modern nations face inevitable decline and decay.¹⁵

THE RADICAL PERSPECTIVE

The Proper Role of Government For Radicals, the proper role of government changes along with the evolution of economic systems. During the mercantilist era preceding capitalism, governments coordinated economic activity with the goal of creating a large economic surplus that could be extracted by government to expand its power. A surplus results from the excess of production over the costs of maintaining labor, land, and capital. The most successful governments extracted part of the surplus through taxation and other fees and used it to provide infrastructure such as roads, bridges, harbors, and national defense. Once capitalism arose in the early 19th century, governments relied on markets to coordinate economic activity but continued to extract part of the surplus for improving the functioning of the market. As capitalism has matured, Radicals call for an enlarged role for government in protecting citizens' rights, supplementing the market, and eventually moving beyond a capitalist economic system.

1. *Protecting rights.* Radicals note that while John Locke defended the natural rights of "life, liberty, and property," the U.S. Declaration of Independence mentions only rights to "life, liberty, and the pursuit of happiness." As revolutionaries aiming to confiscate British property in the United States, the nation's founders recognized that property rights are created and defined through the political process and, therefore, remain subject to revision. Radicals reject the Classical Liberal argument that taxes and regulations violate property rights, but they do acknowledge that any arbitrary confiscation of property would undermine the confidence and security essential to economic prosperity. While Classical Liberals defend only property rights and those civil rights requiring no public resources for their exercise, Radicals propose to create human rights that entitle citizens to protection against poverty, unemployment, and exploitation.

2. *Providing infrastructure.* While most Radicals acknowledge the essential role played by markets in allocating resources, they also believe that markets cannot perform well without physical and social infrastructure provided by government and communities. Physical infrastructure includes roads, bridges, dams, the equipment for national defense, and water treatment and sewage systems. Examples of social infrastructure include

education, health care, the legal system, police and fire protection, and social security programs. Whereas Classical Liberals claim that government provides excessive amounts of infrastructure, Radicals believe that capitalism can be improved with increased government spending to improve the quantity and quality of infrastructure. For example, government could enhance the viability of alternative sources of energy by constructing an open-access power grid so that energy generated in one area could be quickly transmitted to other regions.

3. *Transcending capitalism.* Radicals envision a postcapitalist society that would embody many of the ideals associated with the origins of capitalism, including individual freedom, prosperity, equal opportunity, social justice, and a vibrant democracy.¹⁶ They view capitalism as incapable of fulfilling its own ideals because its tendency to generate excessive inequality enables a relatively small minority of the population to control the political process by which the rules governing the market are established. Most Radicals acknowledge that private property, markets, and the pursuit of profit will likely remain as components of a postcapitalist society. However, they argue that government, communities, and employees should become “stakeholders” with a strong voice in shaping political and economic institutions. Once the rights of stakeholders and the rules of competition have been established through the democratic political process, the market can perform its allocative function.

Perhaps the most difficult task confronting Radical attempts to forge a postcapitalist society is defining precisely the proper role of government. To harness the power of the market, government must be sufficiently strong and autonomous to restrain self-serving private interests that conflict with the public interest; otherwise, powerful private interest groups will gradually use their financial resources to assimilate and capture the government. However, a government with that much power can also become tyrannical and oppressive. Radicals propose to restrain governmental abuses of power with a healthy democracy based on widespread political participation, a knowledgeable electorate, transparent governmental functions, accountability for politicians and bureaucrats, and constitutional constraints.

The Actual Role of Government Radicals engage in an ongoing debate about the actual role of government in a capitalist economy. They distinguish between three distinct theories of the state—instrumentalism, structuralism, and class struggle theory.

1. *Instrumentalism.* Some Radicals portray the government as an instrument used by capitalists to promote their own interests.¹⁷ Foreign policy is oriented toward opening markets and assuring the availability of cheap resources from around the world. Immigration policy assures an inflow of cheap foreign labor to suppress wages. Import quotas and tariffs shield businesses from foreign competition. Government regulations increase the power of large corporations by eliminating smaller competitors. The Radical instrumentalist theory resembles the Classical Liberal claim that government in modern societies has become the tool of powerful interest groups.

From the viewpoint of instrumentalism, businesses use government to socialize costs and privatize benefits. For example, infrastructure such as transportation and communication systems, waste disposal, education, and law enforcement is essential to business, but government provision means that taxpayers bear the cost of maintaining these goods and services. Another socialization of costs is the tax deductibility of business expenses such as meals, entertainment, and depreciation of capital. To privatize benefits, businesses may be involved in the production of goods and services funded by government. For example, private firms supply military weapons and equipment, control the most profitable components of mail delivery, and increasingly provide public services such as incarceration of prisoners and custodial services for public buildings.

Capitalists exert control over government through the selection of political candidates, lobbying, campaign contributions, and the funding of “think tanks” to formulate public policy. They support some benefits for the middle and lower classes as a means to maintain order and preserve the legitimacy of government. However, because capitalists exert their power over government primarily to protect themselves from market forces, Radicals claim that capitalist societies operate on the principle of “socialism for the rich, capitalism for the poor.”

2. *Structuralism*. Another Radical interpretation of government's role in a capitalist economy is called "structuralism." Structural theorists support the instrumentalist argument that government functions primarily to serve the interests of the capitalist class, but they claim that this role is dictated not by capitalist control over government but by the structure of the economy.¹⁸ Since the interests of different sectors of the capitalist class often conflict with each other, forming a consensus among the capitalist class on public policy would be difficult. For example, export industries desire free trade, while industries competing with imported goods often pursue trade protection. However, politicians and bureaucrats in a capitalist economy need not be pressured to create a favorable "business climate" because they recognize that the health of the economy depends on the availability of profitable investment opportunities.

Structural theorists use phrases such as "structural imperatives," "the dictates of accumulation," "systemic constraints," and "laws of motion" to describe the forces emanating from the economy that largely determine the scope and content of government policy. These pressures are transmitted to public policy through two channels. First, because prosperity in a capitalist economy hinges on healthy rates of capital accumulation, citizens tend to identify their own interests with those of business and vote accordingly. For example, employees of a steel mill may oppose regulations to limit air pollution because they fear that reduced profitability for the mill may cost them their jobs. Second, the threat of a "capital strike" poses a continual constraint on public policy. Government actions that undermine profitability may discourage capitalists from investing in the domestic economy. To avoid the recession that would surely follow a strike by capitalists, government must maintain conditions conducive to high profits and continuing investment.

Government policy changes in response to evolving economic conditions. In the 17th and 18th centuries, the interventionist policies associated with mercantilism were appropriate for reducing risk and expanding markets. Once the capitalist economy emerged, laissez-faire policies removed the remnants of feudal and mercantilist restrictions on production and trade. By the late 19th century, the transition to monopoly capitalism required that government protect businesses against the perils of

cutthroat competition by codifying and enforcing regulations and promoting cooperative business associations. The Great Depression of the 1930s led to a vastly enlarged role for government in providing sufficient liquidity and spending to maintain profitability and accumulation. These goals were accomplished by establishing high levels of military spending, by applying expansionary monetary and fiscal policies, and by pursuing greater equality through progressive taxation, support for labor unions, and welfare programs. These latter policies also functioned to maintain social order by easing the plight of low-income families. More recently, global competition has forced many governments to cut taxes, reduce regulations, and privatize public services. From the viewpoint of structuralism, governments have lost much of their autonomy and discretion due to the dictates of international competition. For example, national governments are reluctant to enact a tax on carbon emissions to slow global climate change for fear that domestic producers will lose their competitive advantage in global markets.

3. *Class struggle theory.* A third Radical theory of government portrays politics as an arena in which conflicting class interests vie with one another for dominance. As a “contested instrument,” government potentially serves the interests of either capitalists or workers, depending on the balance of class power at any given time.¹⁹ The basis for class struggle theory lies in the claim that government must not only promote capital accumulation but also legitimize itself and the capitalist system in the eyes of the public.²⁰ Accumulation is essential for economic prosperity, but the viability of capitalism also requires that a broad spectrum of the population perceives the system to be legitimate, and government efforts to promote legitimacy may conflict with the narrow interests of capitalists in maximizing short-run profits. For example, taxation, regulations, and minimum wage laws may reduce profits for some businesses, but without such policies, social unrest might threaten the entire capitalist system.

Proposals for Political Reform Radicals who adhere to either instrumentalism or structuralism tend to be pessimistic about the prospects for political reform within capitalism. Whether government is controlled by the ruling class or by the structural imperatives of the

economy, political change remains unlikely until a crisis threatens the very survival of the capitalist system. However, class struggle theory raises the possibility that reform efforts may improve if not transcend capitalism. Reform-minded Radicals concede that the capitalist class will strongly resist challenges to its power, but they feel optimistic that a combination of legal reforms, government policies, and a broad-based working class political movement may achieve fundamental change in the economic system.

While nearly all Radical proposals for political reform call for an enlarged role for government, Radicals acknowledge the potential danger posed by increased government power. If, as happened in Italy and Germany in the 1920s, large numbers of citizens and business owners blame foreigners, minorities, and democracy for the nation's economic woes, then state power could take the form of fascism. Alternatively, growing hostility toward capitalism could lead to a repressive, non-democratic communism as existed in the Soviet Union and China during the 20th century. A third danger associated with powerful government is a form of "friendly fascism" in which government does not wage war or exterminate minorities but relies on "the iron fist in the velvet glove" to enforce austerity measures, spy on citizens, silence political dissent, and restore conditions for rapid capital accumulation.²¹

To assure that government remains fully democratic while promoting greater social equality, Radicals advocate several political reforms to broaden human rights, ensure equal opportunity, and establish participatory democracy.

1. *Human rights.* Government currently protects property rights and those civil rights enumerated in the U.S. Bill of Rights such as freedom of speech, worship, and the press. Radicals propose to supplement these rights with a Bill of Human Rights conferring protection against poverty, discrimination, and exploitation. These human rights might include rights to a job, affordable housing, a livable wage, a clean environment, occupational safety, and affordable insurance against sickness, disability, and infirmity. Some Radicals support a right to a guaranteed annual income or a right to a social inheritance at the age of 21.²²

2. *Equal opportunity.* Radicals support human rights because they believe that equal opportunity requires significantly greater social and economic equality. Excessive inequality reduces social mobility and thereby dampens the energy and aspirations essential to a healthy economy. When equal opportunity is so obviously lacking, citizens become cynical, apathetic, and frustrated, resulting in low productivity, crime, and substance abuse. Equal opportunity entails not only a fair chance for economic success but also a voice in determining the rules and institutions by which communities, work places, and government are organized.

3. *Participatory democracy.* In light of the disappointing performance of Soviet-style socialism, most Radicals have abandoned the vision of a postcapitalist society based on nationalization of the means of production and centralized planning. Instead, they propose to make authority in both the private sector and government open to popular input and democratically accountable. This vision of “participatory democracy” entails decentralization of authority throughout society and increased worker and community input into business and government decision-making.²³ The economy might be structured around a mixture of publicly and privately owned businesses, reliance on both the government and the market to allocate resources, and sufficient inequality in wealth and income to provide incentives for productive activity. To realize the democratic ideal of “one person, one vote,” Radicals would provide public financing of political campaigns, assure that all voters have equal access to the ballot box, and significantly restrict the influence of money on the political process.

THE CONSERVATIVE PERSPECTIVE

The Proper Role of Government Conservative attitudes toward government have changed dramatically over time, and even today, the proper role of government remains the subject of much debate. During the early 19th century, when Conservatives still controlled most European nations, they looked to government to preserve the hierarchical, aristocratic social order against the challenges posed by

liberalism, capitalism, and democracy. In contrast to Classical Liberals, who focused on expanding individual freedom by limiting the power of the state, Conservatives viewed government as playing an essential role in upholding traditional morality and the established social order.

A dominant theme in 19th-century Conservative thought was the concept of a “natural order” consisting of cohesive communities, in which the most wise and charismatic individuals ascended to positions of leadership and authority. An overarching national community would unify local communities by instilling patriotism and a sense of shared identity through symbols and traditions such as flags, monuments, anthems, and pledges of allegiance. The natural order would be harmonious as the socialization process conditioned individuals to accept their position in the social hierarchy. When the natural order prevailed, local communities would be largely self-governing and the national government would have few responsibilities other than national defense and maintaining domestic tranquility.

In the 20th century, however, the social disruptions caused by two world wars and the Great Depression shattered the illusion of a natural order. Small communities governed by local elites were overwhelmed by the forces of industrialization, urbanization, and immigration. Moreover, as the right to vote extended beyond male property owners, Conservatives could no longer rely on government to defend the status quo. Under the pressure of popular demands, democratic governments used their power to tax and regulate elites while providing social benefits for the masses. By the end of WWII, as the threat of communism confirmed Conservatives’ worst fears about governmental power, they embraced capitalism and joined with Classical Liberals in the effort to restrain the expanding role of government. From the Conservative perspective, the scope of government’s authority should be limited to the following functions and practices: 1. *Maintaining law and order*. Conservatives reject the Enlightenment view of humans as rational calculators of self-interest. Instead, they argue that human nature is fundamentally flawed, exhibiting passions and vices that threaten social order. Civilization and culture are merely thin veneers susceptible to disruption by individuals lacking proper socialization. To assure a peaceful

and stable society, government must be strong enough to enact and enforce laws and subsequently to suppress any violations of those laws.

2. *Protecting property rights.* From the Conservative perspective, government must provide assurance to citizens that it will protect their property rights from violations by other citizens or by government itself. Without confidence in the sanctity of property rights, individuals will be reluctant to improve the quality of their assets, to engage in transactions requiring contracts, or to undertake risky ventures. The knowledge that property rights are enforceable through the power of government creates the confidence essential for economic prosperity.²⁴

3. *Protecting intermediate institutions.* Conservatives use the term “intermediate institutions” to refer to small communities such as churches, clubs, organized recreational groups, extended families, civic organizations, and local governments that serve as buffers between the individual and the impersonal and potentially destabilizing forces of both markets and the national government.²⁵ From the Conservative perspective, these intermediate institutions are essential to the socialization process by which individuals learn morality and social responsibility. The informal hierarchies arising spontaneously from differences in abilities provide the basis for habitual deference to authority and respect for others. These social bonds generate loyalty to friends, duty to family, devotion to church, and patriotism toward country. Intermediate institutions spontaneously develop systems of informal rules to coordinate activity, thus minimizing the need for overt exercises of government authority. Moreover, these informal rules do not pose restraints on individual freedom since they arise from the shared moral beliefs of community members. Most individuals willingly accept their social duties and obligations.

Conservatives acknowledge that intermediate institutions are vulnerable to both the self-interested behavior of market activity and the power of government. They have struggled to develop policies to protect and revitalize intermediate institutions while simultaneously preserving the efficiency of markets and the necessary degree of governmental authority. If government assumes too much responsibility for the security of small

communities, individual responsibility and initiative will suffer. In contrast, if government ignores intermediate institutions, they are vulnerable to disintegration in the face of larger economic and political forces.

4. *Promoting virtue.* Conservatives believe that government should serve as more than a neutral referee protecting individual rights. It should maintain a moral and cultural climate conducive to the development of stable communities and virtuous individuals. According to George Will, government should actively mold the “manners and morals” of citizens. Like a tutor, government should foster proper sentiments, opinions, and behavior by helping “persons want what they ought to want.” George Will rejects the liberal commitment to keep morality out of public life. A government that fails to intentionally promote particular values such as a work ethic, self-discipline, loyalty, and patriotism will have citizens devoid of civic virtue. In Will’s words, “a completely and permanently open mind will be an empty mind.”²⁶

5. *Limited democracy.* After witnessing the rise of communism and fascism in the 20th century, Conservatives accepted democracy as, in the words of Winston Churchill, “the worst form of government except for all the others that have been tried.”²⁷ Conservatives have traditionally expressed qualms about democracy, fearing that it would lead to a “tyranny of the majority” and “rule by the mob.” Alexis de Tocqueville (1805–1859), a French sociologist who traveled through the United States in 1836, was concerned about “democratic despotism” by politicians enacting egalitarian policies in hopes of attracting more voters.²⁸ Two Italian social theorists, Vilfredo Pareto (1848–1923) and Gaetano Mosca (1858–1941), claimed that democracy could destabilize the natural hierarchical order in which authority was based on differences in individual abilities and temperaments.²⁹

By the 20th century, Conservative writers developed theories of mass behavior, arguing that the dislocations caused by industrialization uprooted citizens from traditional communities and created an urban working class prone to irrational and violent behavior.³⁰ In this context, democracy would allow demagogues to rise to power by pandering to the fears and resentment

of the masses. According to Conservatives, democracy is prone to demagoguery because the majority of voters lack sufficient knowledge and virtue to vote wisely. To insulate government from democratic pressures, Joseph Schumpeter (1883–1950) proposed that popular participation in politics should be limited to periodic elections and that political candidates should be members of the social elite whose financial independence allows them to rise above the pursuit of wealth and power.³¹

Conservatives also attempt to curb democracy by structuring government in ways that divide and balance political power. They note that the U.S. Constitution was intentionally designed to limit direct democracy by creating three branches of government, each holding separate powers. Within the legislative branch, the Senate was originally shielded from popular pressures by placing responsibility for choosing senators with state legislatures. The Senate could effectively derail any measures passed by the popularly elected House of Representatives.

6. *Isolationism*. Conservatives have traditionally opposed government involvement in foreign affairs. In the 19th century, Conservatives viewed imperialism as disrupting the natural orders of both industrialized and developing countries. In the 20th century, they tended to oppose U.S. involvement in both World War I (WWI) and WWII. However, in the aftermath of WWII, the expansion of communism persuaded many Conservatives to abandon isolationism and support an aggressive foreign policy. Since the collapse of the Soviet Union in 1991, Conservatives have split over the issue of foreign involvement. On one side of the debate stand neoconservatives who favor active efforts, including military intervention, by governments in industrialized countries to engage in “nation building” by spreading Western values and institutions throughout the world. On the other side are the so-called paleoconservatives who insist that industrialized nations only weaken themselves and fuel terrorism by imposing their will on developing nations.

The Actual Role of Government According to Conservatives, the values associated with the Enlightenment—individual autonomy, moral relativism, materialism, and self-interest—have steadily eroded the

essential foundations of a stable society. Individual virtue and social order have been corrupted by the pursuit of wealth and pleasure. Urbanization and geographic mobility have undermined traditional communities and the legitimacy of traditional authority.³² As market forces wrench individuals from their emotional attachments to particular people and places, the intermediate institutions of family, community, and church become marginalized. In the absence of a natural order, the disintegrating forces of individualism and materialism cause government to take on increasing power and responsibilities. However, the expansion of government fails to resolve social problems because government power further disrupts the natural order in the following ways: 1. *Mass democracy*. Conservatives argue that democracy has been corrupted by liberal efforts to remove limits on direct democracy and thereby extend participation in the political process.³³ For example, the 1913 passage of the Seventeenth Amendment to the U.S. Constitution opened selection of senators to the popular vote.³⁴ Conservatives claim that competition for votes fosters demagoguery as politicians pander to the masses with promises of social benefits and grand schemes for social improvement. Demagogues upset the natural order by fueling resentment among the masses and persecuting elites.

2. *Managerial state*. According to Conservatives, modern governments impose a liberal vision of the good society by creating and protecting positive individual rights entitling citizens to social benefits. Conservatives use the term “social engineering” to describe efforts by government to change traditional behaviors and social institutions by enacting new laws and regulations. Government has become the “nanny state,” treating citizens like children in need of discipline and supervision.

3. *Undermining intermediate institutions*. While Classical Liberals believe that the greatest threat posed by government is its potential for restricting individual freedom, Conservatives fear government’s tendency to undermine “intermediate institutions” such as family, church, and neighborhood that serve as protective buffers against both market forces and government power. By regulating individual behavior and providing

social benefits such as welfare, employment, housing, and health care, government displaces the role of intermediate institutions in nurturing and supporting citizens. The wisdom and authority of parents, clergy, and local officials are replaced by social workers, service professionals, and bureaucrats. Moreover, the decline of intermediate institutions becomes self-perpetuating as their disintegration leads to increasing social ills and subsequent rationales for establishing additional government programs.³⁵

4. *Eroding virtue.* As the expanding role of government causes intermediate institutions to wither, individuals become socially isolated. Lacking a strong sense of community and shared culture, they focus on immediate gratification of desires at the expense of virtues such as honesty, trust, civility, deference to authority, individual responsibility, and self-restraint. Paradoxically, the extreme individualism resulting from the weakening of self-restraint paves the way for authoritarian government. When individuals fail to learn self-discipline and obedience to authority in their families, workplaces, and communities, the power of government expands to prevent the pursuit of self-interest from degenerating into chaos. Conservatives also blame liberal government for marginalizing religion by maintaining an excessive separation of church and state. As government attempts to remain impartial toward competing values, it weakens citizens' commitment to any particular belief system. The liberal value of tolerance implies that all beliefs are equally worthy of respect, but tolerance fails to distinguish between virtue and vice. Citizens are left adrift in a sea of ethical relativism with no community moral standards to guide their conduct.

Proposals for Political Reform Conservatives face a dilemma in formulating political reforms. Since they blame government for exacerbating many of the social ills afflicting modern societies, they remain doubtful about government's potential for solving these problems. Yet, to adopt the Classical Liberal stance of laissez-faire would allow the corrosive effects of the market to spread unchecked. Lacking confidence in both democratic government and the free market, Conservatives call for dramatic changes in the role of government to

restore those precapitalist institutions and values deemed essential to a healthy capitalist economy.³⁶

1. *State corporatism*. In the late 19th century, as industrialization was breeding increasing labor unrest and demands for socialism, some European Conservatives and the Catholic Church proposed to minimize class conflict by creating social groupings within which individuals would gain a renewed sense of fellowship and community. These groups were called “corporations” (derived from *corpus*, the Latin term for “body”) and would function much like feudal guilds, manors, and villages that once provided a supportive social context for individuals. Each profession, industry, or skill might form a corporation under the guidance of government. The rationale behind state corporatism was to reduce class hostility by officially recognizing the significance of all groups and controlling the “cutthroat competition” that threatened the security of all citizens. Any potential conflict would be resolved through mediation involving representatives of the different corporations and government officials.³⁷ State corporatism represented an attempt to harness the dynamism of capitalism while minimizing its potential for instability, conflict, and the erosion of communities.

During the 20th century, the idea of state corporatism formed the basis for fascism in Germany, Italy, and Japan. It also materialized in more moderate form in Spain, Portugal, Brazil, Argentina, and Austria. In the United States, the success of business–government cooperation during WWI persuaded many industrialists that corporatism was the wave of the future. During the Great Depression, corporatism underlay the National Industrial Recovery Act (NIRA) of 1933, which permitted businesses to form industry associations for cooperating with one another in establishing plans for production and pricing. Ironically, had the Supreme Court not declared the NIRA unconstitutional in 1935, the United States would have embarked on a course bearing similarities to the institutional framework of Nazi Germany. After WWII, corporatism was largely discredited in the United States due to its similarity to fascism. However, some Conservatives continue to be attracted by the prospect of a coordinated economy with no labor strikes and stable profits. During the economic turmoil of the 1970s,

corporatist proposals were formulated by David Rockefeller's Trilateral Commission and by Henry Ford's Initiative Committee on Economic Planning.³⁸

2. *Nurturing intermediate institutions.* According to Conservatives, intermediate institutions such as families, communities, civic organizations, and local governments are essential in promoting personal development and social stability. As the impersonal forces of markets and government weaken intermediate institutions, the individual is left, in the words of sociologist Robert Nisbet (1913–1996), “free in all his solitary misery.”³⁹ However, Conservatives believe that government can play a positive role in supporting intermediate institutions. The principle of subsidiarity and the doctrine of states' rights both propose to delegate the functions of government to the lowest possible levels, granting state and local governments increased power relative to the national government. By granting more functions to local governments and community organizations, the national government would strengthen these intermediate institutions by increasing their relevance in citizens' lives.

Conservative support for intermediate institutions materialized with the 2001 establishment of the White House Office of Faith-Based and Community Initiatives that channeled government funding to churches and community organizations offering social services to aid the poor. While government grants to churches would seem to violate the principle of separation of church and state, Conservatives argue that churches are better suited than welfare agencies to reach out to the poor and draw them into supportive groups where community contact and mentoring can guide them toward securing employment and leading meaningful lives.

Some Conservatives support tariffs on imported goods to prevent the disintegration of communities due to corporate outsourcing and job loss. Conservatives also favor tight restrictions on immigration in order to prevent the erosion of traditional communities and cultures. They view “multiculturalism” as a threat to the integrity of all distinct cultures because it weakens the emotional attachments of citizens to their unique heritage and traditions.⁴⁰

3. *Promoting virtue.* Although Conservatives partially blame government for undermining the virtue of citizens, they envision certain public policies that might protect and promote morality. In addition to current laws prohibiting activities such as prostitution, recreational drug use, gambling, and some pornography, Conservatives have proposed censorship of the media, overturning the 1973 Supreme Court decision in *Roe v. Wade* that legalized abortion, and relaxing the separation of church and state so that religion can play a more prominent role in public spaces. Some Conservatives favor “pro-family” policies such as tax breaks for married couples, government grants to parents who remain at home to raise children, and subsidies for families based on the number of children. Conservatives also propose that public schools should emphasize the teaching of values such as patriotism, duty, respect for authority, hard work, and self-discipline.

4. *Restricting voting rights.* Because many Conservatives believe that citizens lack information and, therefore, can be easily manipulated by politicians promising economic benefits, they propose various limits on the right to vote. In the 19th century, Conservatives opposed extending the franchise to men without property and to all women. In the 20th century, Conservatives relied on literacy tests and poll taxes to prevent poor and less-educated citizens from voting. Today, some legislatures have enacted laws requiring citizens to have a state-issued identification card in order to vote. Other tactics aimed at reducing voter participation include cuts in funding and shorter hours for polling places, tighter restrictions on absentee ballots, and proposals that only citizens paying taxes should be eligible to vote.

5. *Strict constructionism.* Like Classical Liberals, most Conservatives insist on interpreting the U.S. Constitution in accordance with the original intent of its designers. The Federalist Society, a Conservative organization of lawyers, law students, and law professors, attempts to reform the U.S. legal system to restrict the role of the Federal government to those responsibilities enumerated in the Constitution.⁴¹ This “strict constructionism” would, for example, prohibit the national government

from regulating commerce unless it crossed state borders and would give state and local government greater autonomy in formulating public policy.

THE MODERN LIBERAL PERSPECTIVE

The Proper Role of Government Modern Liberals have been the chief proponents of the dramatic expansion of government during the past century. From their perspective, a mixed economy, combining capitalism and an active democratic government, offers a middle path between the disruptive forces of unbridled capitalism and the totalitarianism of fascism or communism. Modern Liberals envision harnessing the dynamic potential of capitalism for creating prosperity while relying on government to maintain freedom, justice, and a degree of security for all citizens.

Modern Liberal economists have developed a variety of theoretical arguments to reveal flaws in the operation of markets. These “market failures” fall into six broad categories—lack of competition, externalities, lack of public goods, instability, inequity, and socially undesirable outcomes.⁴² Through appropriate policies, Modern Liberals believe that market failures can be largely corrected by government intervention.

1. *Maintaining competition.* Markets will fail to achieve economic efficiency if the conditions of perfect competition are violated. A perfectly competitive market encompasses many small buyers and sellers of a homogeneous product. In addition, resources are perfectly mobile in the sense that they can shift quickly from one industry to another, and participants possess full knowledge of all information relevant to making rational economic decisions. Rarely is any one of these conditions met, let alone all of them simultaneously.

Government can remedy some of the impediments to perfect competition. When information is lacking, government can either provide it or mandate that private parties do so. For example, pharmaceutical companies must publicize any potential side effects of prescription drugs,

and food manufacturers are required to list product ingredients on labels. Similarly, the mobility of resources can be improved through government actions such as job retraining programs and subsidies for moving expenses.

Perfect competition requires small buyers and sellers, but many industries are dominated by a few large corporations. These oligopolies arise due to “economies of scale” that occur when the cost of producing a unit of output decreases as the size of the firm increases. Economies of scale give large corporations a competitive advantage over small businesses due to lower per-unit costs of production and can eventually lead to dominance of an industry by the largest firm. To remedy this tendency for competition to eliminate itself, Modern Liberals propose either antitrust laws to block corporate mergers and acquisitions or government regulation of “natural monopolies” such as utilities.

2. *Correcting externalities.* An externality arises when a market transaction results in benefits or damages to “third parties” other than the buyer and seller. Externalities occur because of missing markets; buyers and sellers cannot negotiate certain exchanges due to high “transaction costs” of gathering information, specifying contracts, and monitoring compliance. Because the market responds only to the private costs and benefits of any good or activity, it will yield more than the optimal amount of products with negative externalities and less than the optimal amount of products with positive externalities. For example, the free market results in too much pollution and too little education.

Government possesses three methods for correcting externalities. One solution lies in its ability to tax products creating negative externalities (e.g., cigarettes) and to subsidize products or activities generating positive externalities (e.g., scientific research). Alternatively, government may prohibit activities with negative externalities (e.g., underage drinking) and require activities with positive externalities (e.g., elementary education). Finally, government can create a market that reflects external costs and benefits. For example, to reduce the negative externality associated with pollution, government could sell licenses to firms allowing them to emit only a limited amount of pollution.

3. *Providing public goods.* An extreme case of a positive externality arises when nearly every person in society would benefit from a good or service but, because most of the benefits are external to the market, individual consumers cannot be charged and no private firm can profitably produce the good. Public goods such as national defense, highways, and police protection share two characteristics. They are nonexclusive (i.e., nonpayers cannot be excluded from enjoying the benefits), and they are nonrival (i.e., one person's enjoyment of the benefits does not diminish the availability of the good for others). Public goods are not produced by private businesses because of the "free rider problem." When individuals realize that they can enjoy the benefits of the good whether they pay or not, they lack any incentive to pay and will instead attempt to take a "free ride." Since the market fails to provide public goods, government must finance them with tax revenue. Modern Liberals believe that government provides inadequate amounts of public goods, as reflected in the deteriorating condition of many highways, bridges, and schools. Modern Liberals reject the Classical Liberal claim that "government failures" will inevitably undermine any attempts by government to correct "market failures." Modern Liberals also oppose Classical Liberal efforts to privatize the provision of public goods and services, arguing that privatization results in profits for private firms at the expense of lower wages for workers and reduced quality of services.⁴³

4. *Stabilizing the economy.* The Great Depression persuaded Modern Liberals that a market economy is inherently prone to cycles of boom and bust and that government must intervene to stabilize the economy through monetary and fiscal policy. Government also relies on "automatic stabilizers" such as welfare programs and unemployment compensation that cause government spending to increase as soon as the economy begins to slow and to reduce spending when a recovery begins. Modern Liberals also believe that government can reduce instability by developing broad policies to encourage the growth of new industries and ease the transition away from declining industries.

5. *Promoting justice.* The market-determined distribution of income is only as fair as the distribution of productive assets held by individuals as they enter into market transactions. In other words, a person who owns substantial productive assets will usually receive a correspondingly high income and vice versa. In the past, Modern Liberals hesitated to advocate extensive redistribution of income for fear of reducing incentives for productive activity. Instead, they favored regulations such as minimum wage laws, antidiscrimination laws, and agricultural price supports that indirectly redistribute income by establishing economic rights. Modern Liberals also support government provision of basic necessities that everyone should receive regardless of ability to pay. These “merit goods” include food, clothing, shelter, health care, and education.⁴⁴

In recent decades, the sharp rise in inequality has led many Modern Liberals to conclude that the current distribution of wealth violates any reasonable standard of fairness. They now propose renewed efforts to achieve greater justice by increasing the progressivity of the income tax, enlarging the earned income tax credit, closing tax loopholes that favor the wealthy, enacting a tax on all financial transactions, and taxing excessive wealth. In addition to promoting justice, the revenue from these taxes would enable government to carry out its other essential roles without enlarging the budget deficit and national debt. Finally, some Modern Liberals have recently proposed government efforts to influence the salary levels of corporate CEOs and other high-level management personnel. One proposal would draw attention to corporate salaries in hopes that public outrage would curb some of the excesses, while another would establish limits on the ratio of the CEO’s salary to that of the average worker’s pay within any single corporation.

6. *Achieving social goals.* The market is capable of fulfilling only those human desires and needs that can be met with commodities. Moreover, the market may yield results conflicting with widely-held social values. While Modern Liberals defend individual autonomy and choice, they also support some government efforts to encourage or discourage certain behaviors or products. For example, because many citizens predictably fail to save enough money for retirement, the government mandates payments into the

social security system. Society is improved by widespread education, so the government requires school attendance or home schooling until the age of 16. To minimize the coercive and paternalistic aspects of rules and regulations, Modern Liberals suggest that a simple “nudge” is sometimes sufficient to change individual decisions.⁴⁵ As an example, when employees are given the opportunity to enroll in a tax-deferred saving plan, many fail to do so. But if they are instead initially subscribed to a saving plan with an option to exit, more of them will remain enrolled. In both cases, employees are free to choose, but by framing the options differently, the goal of increased saving for retirement is achieved.

The Actual Role of Government The concentration of wealth and power in capitalist nations challenges the Modern Liberal view of government as a benevolent administrator and impartial defender of the public interest. Government is increasingly subjected to pressure from large, well-organized interest groups. In light of this changing political landscape, political scientists such as Robert Dahl (1915–2014), David Easton (1917–2014), and David Truman (1913–2003) revised the Modern Liberal view of government by introducing the concept of “interest-group pluralism.”⁴⁶ Pluralist theorists acknowledge the concentration of wealth but attempt to preserve the image of democratic government as representative of the public interest by distinguishing between economic power and political power. They concede that concentrated wealth allows capitalists to gain an advantage in the market but argue that groups wield political power in proportion to the size of their membership. Therefore, labor unions or senior citizens’ groups with high rates of voter turnout may exert as much political power as corporations. In other words, the democratic political process responds to numbers of votes rather than money, and government policies reflect the balance of political power between competing interest groups.

Interest-group pluralism has proven to be problematic for Modern Liberals.⁴⁷ By legitimizing competition among interest groups to influence government, pluralism portrays politics as a battleground rather than a means for promoting the common good. With no shared vision of the public interest to serve as a basis for reaching consensus, politics degenerates into

a Hobbesian “war of all against all,” with each group seeking to use the power of government to its own advantage. As a result, government programs providing benefits to different groups proliferate, budget deficits swell, and public confidence in government deteriorates.

Modern Liberalism has been on the defensive since the 1970s due to a fundamental dilemma. On one hand, its commitment to individual freedom and autonomy precludes any clear conception of the public interest. But without that conception, government possesses no clear guidelines for distinguishing between legitimate private interests seeking expression through government and mere rent-seeking. This dilemma should come as no surprise since Modern Liberalism arose as an attempt to synthesize the Classical Liberal defense of individual freedom and the Radical vision of a more just society.

In an effort to resolve these internal contradictions, Modern Liberals have sided with Classical Liberals in defending individual rights while joining Radicals in condemning the power of corporate interests to corrupt the political process.⁴⁸ With the expanding role of money in politics, most Modern Liberals have abandoned the notion of interest-group pluralism because it downplays the link between economic power and political power. Clearly, money influences politics, and politicians return the favor by using their power to reward benefactors.

Modern Liberals believe that the Constitution should be subject to reinterpretation in light of changing economic conditions. In the early 20th century, Modern Liberal jurists such as Oliver Wendell Holmes, Jr. (1841–1935), Louis Brandeis (1856–1941), and Roscoe Pound (1870–1964) argued that a document created in the 18th century could not possibly address all the issues associated with modern industrial economies. They viewed the Constitution as a “living document” designed to adapt to an evolving economic system. As a result of their loose interpretation of the Constitution, the role of government expanded dramatically in the 20th century.⁴⁹

Proposals for Political Reform The Modern Liberal agenda for political reform includes the goals of promoting political equality, expanding the

public sector, and cooperating with other nations to develop rules and regulations for governing the global economy.

1. *Promoting political equality.* Modern Liberals believe that the problems posed by concentrated economic power can be at least partially alleviated by improving the quality of democracy.⁵⁰ The principle of “one person, one vote” implies that each citizen should have equal political power regardless of economic status. Modern Liberals offer a variety of proposals to promote political equality. Their top priority is campaign finance reform in order to limit the influence of money in politics. Modern Liberals would overturn the 2010 Supreme Court decision in *Citizens United v. Federal Election Commission* that removed nearly all restrictions on financial contributions to political campaigns. The Supreme Court based that decision on the assumptions that corporations are persons with the same constitutional rights as any citizen and that financial contributions are tantamount to speech and therefore protected by the Constitution. Modern Liberals challenge the constitutional validity of both those assumptions. To minimize the influence of private monetary contributions in politics, Modern Liberals favor government funding of political campaigns so that politicians are not beholden to their donors.

In seeking greater political equality, Modern Liberals emphasize the importance of transparency and accountability in government affairs. To the extent consistent with national security, legislative and regulatory actions should be well publicized and politicians and bureaucrats should be held accountable for their actions. Modern Liberals would place tighter restrictions on corporate lobbying and gifts in order to thwart efforts to “capture” control of government agencies.⁵¹ They would revise the procedures for delineating the borders of congressional districts in order to end the process known as gerrymandering. Currently, the majority party effectively selects its voters by creating “safe districts,” in which that party is supported by an overwhelming majority of voters. Modern Liberals propose instead to create bipartisan public commissions to establish the boundaries of congressional districts. To increase participation in elections, Modern Liberals would eliminate nearly all eligibility requirements, allow voting by mail, and keep polling booths open for extended hours.

2. *Expanding the public sector.* Modern Liberals offer several reasons why government should be expected to grow in size and scope as society matures. First, population growth and industrialization create more externalities such as pollution and depletion of resources, which call for additional government intervention. Also, as incomes rise and the basic needs of most citizens are met, the demand for public goods such as a clean environment, education, and health care increases. Finally, many of the services provided by government are labor intensive. Because technological progress in the service sector is slower than in manufacturing, the cost of government can be expected to rise faster than the cost of manufactured goods.⁵²

Modern Liberals also view an active government as essential to any nation's success in the global economy. Natural resources and capital can be obtained through global markets, so the most crucial prerequisites for economic growth are an educated labor force, extensive research and development, and high-quality infrastructure. All of these public goods are enhanced by government funding or provision. Modern Liberals would like to see government adopt an "industrial policy" to develop strategies and allocate resources for rebuilding infrastructure and promoting the most promising industries of the future.⁵³

3. *International cooperation.* During the half century after WWII, Modern Liberals constructed an elaborate framework of taxes and regulations designed to improve the functioning of a market economy. Globalization has undermined the viability of that framework by allowing businesses to outsource production and relocate operations to countries with lower taxes, less regulation, and cheaper labor. Modern Liberals foresee a "race to the bottom" as nations vie with one another to reduce taxes and regulations in order to attract additional businesses and investment. The "winners" of this race will experience more polluted environments, lower wages, inadequate infrastructure, and increasing class inequality. For the benefit of all nations, Modern Liberals favor regional and global agreements on trade policies, regulatory standards, taxation, and protection of human rights.

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Chapter 8

Inflation and Unemployment

Macroeconomic instability, also known as “the business cycle,” has been an enduring feature of capitalism since its inception. Periods of strong growth typically end with a recession imposing losses on investors, businesses, workers, and households. To protect themselves against the insecurity caused by business cycles, labor unions, corporations, and government have attempted to control the operation of the market and, in doing so, have transformed the institutional structure of capitalism.

Although relative stability during the decades following World War II (WWII) persuaded many economists that the business cycle had been tamed, the global financial meltdown of 2008 demonstrated a continuing inability to control or even fully understand the sources of instability. Contemporary political economists debate the underlying causes of instability and the merits of alternative policies for combating inflation and unemployment. In this chapter, we investigate those arguments and contrast the competing explanations for and solutions to the Great Recession that began in 2007. The global economy is still experiencing the repercussions of that event.

THE CLASSICAL LIBERAL PERSPECTIVE

Causes of Instability

Classical Liberals view the competitive market as prone to minor instability but also capable of self-correction. Since the market contains its own equilibrating processes, government efforts to maintain stability are not only unnecessary but can often be harmful. According to Classical Liberals, the threat of recession benefits the economy by restraining overconfidence among investors and business owners. The knowledge of the inevitability of a future recession makes all market participants more cautious and judicious in their financial decisions. Even when recessions occur, Classical Liberals remain confident of the market's ability to restore equilibrium quickly and automatically and to establish the basis for renewed growth.

One of the first theoretical arguments for the stability of markets was formulated by French economist Jean Baptiste Say (1767–1832). Say's Law states that supply creates its own demand. In other words, in the process of producing goods and services, the amount of income paid to the various factors of production equals the value of the goods and services produced, so there will always be sufficient demand to purchase goods and services. Say acknowledged that some income is saved, but interest rates should rise or fall to assure that savings are matched by an equal amount of borrowing, so total spending equals total income. Say's Law does not imply that every commodity is guaranteed to sell, but it suggests that the total amount of spending on consumption and investment will be equal to the value of output. The fact that some goods remain unsold is merely a temporary phenomenon as production shifts to more desired commodities. Furthermore, market incentives facilitate the rapid movement of resources into more profitable lines of production. These transitions normally occur so smoothly that the economy as a whole experiences little or no disruption. Any unemployment will be temporary as workers move from declining to expanding industries and occupations.

Despite Say's Law, economies in the real world obviously do experience severe fluctuations. Classical Liberals offer the following explanations for these disruptions: 1. *Exogenous forces*. Classical Liberals of the 19th century remained so convinced of the inherent stability of a market economy that they attributed business cycles to forces outside the market. English economist Stanley Jevons (1835–1882), for example, claimed that sunspots adversely affect agricultural output, thereby causing the entire economy to slump. Other economists attributed business cycles to periodic

discoveries of gold, waves of emigration, or wars. These explanations of instability remained dominant until the Great Depression of the 1930s, which was so severe that it discredited Classical Liberalism for the next four decades.

2. *Monetary policy.* The Classical Liberal explanation of the Great Depression came primarily from Austrian economists Ludwig von Mises (1881–1973) and Friedrich Hayek (1899–1992). Pointing to the Federal Reserve System that had been created in 1913, they insisted that mismanagement of the money supply caused the Great Depression.¹ This claim that excesses or shortages of money cause instability is known as “monetarism.” If the central bank (e.g., the Federal Reserve) issues too much money, interest rates drop, borrowing and spending increase, and inflationary pressures begin to develop. Eventually, the central bank must tighten the money supply to control inflation, thereby driving interest rates upward, discouraging borrowing, and causing a recession.

Slightly revising the Austrian viewpoint, U.S. economist Milton Friedman (1912–2006) blamed the Federal Reserve for causing the Great Depression by not creating enough money to prevent the economy from collapsing in 1929.² Friedman also claimed that the natural equilibrating forces of the market would have quickly restored prosperity had not Congress enacted the 1930 Smoot–Hawley tariff to prevent foreign goods from entering the country. That action caused other nations to retaliate by establishing their own tariffs, international trade plummeted, and the Depression lasted for another decade.

As Keynesian economics and Franklin Roosevelt’s New Deal gained acceptance after WWII, the Austrian economists, along with Friedman, were marginalized within the economics profession until the global economy began to experience serious instability in the 1970s. The inability of Keynesian economics to cope with “stagflation” (i.e., simultaneous stagnation and inflation) opened the door for a resurgence of Classical Liberalism as Hayek and Friedman became the “intellectual godfathers” of the “Reagan revolution.”

3. *Fiscal policy*. Because Keynesian economics calls for the use of fiscal policy (i.e., changes in government spending and taxation) to stabilize the economy, Classical Liberals have been determined to discredit fiscal policy by demonstrating its role in causing instability. Their first line of attack argues that decisions about spending and taxation are made by politicians rather than economists. To please voters, politicians authorize increased spending to benefit various constituencies and keep taxes as low as possible. The result is continual deficits in the Federal budget rather than the “fine-tuning” (i.e., small adjustments in government spending and taxation) called for by Keynesian economics to keep the economy on a steady growth path.

Budget deficits force the government to increase its borrowing, potentially leading to a “crowding-out effect.” Government borrows money by selling bonds in the same credit markets as private sellers of bonds. The additional borrowing by government causes higher interest rates for all borrowers, thereby discouraging private borrowing and investment. In other words, any stimulus to the economy provided by government spending financed through borrowing may be offset by a decline in private investment.

Another Classical Liberal argument blaming fiscal policy for causing instability is the concept of the “political business cycle.” In the year preceding a major election, politicians may authorize additional spending to stimulate the economy so that citizens enter the voting booth with positive attitudes toward incumbent candidates. When the election is over, a contractionary fiscal policy is applied to dampen the inflationary pressures arising from the previous stimulus. If this theory is correct, some of the instability of the economy is caused by political schemes to win elections rather than any inherent failure of the market.³

Classical Liberals believe that both fiscal and monetary policies destabilize the economy due to three time lags that may exacerbate rather than reduce fluctuations in the economy. A recognition lag is the time needed for policy makers to become aware that inflation or recession is imminent. An implementation lag denotes the time during which government or the Federal Reserve formulates and enacts the policy response, and an impact lag consists of the time before the policy actually

affects the economy. The combination of these three time lags could last as long as two years, meaning that the business cycle may have progressed to a different stage and the policy become counterproductive. For example, if the government perceives a slowing of the economy and responds with increased spending on public works projects, the recession may have ended by the time the projects actually commence.

4. *Regulations.* Classical Liberals blame government regulations for much of the failure of capitalist economies to generate full employment and sustained growth. For example, they attribute the length and severity of the Great Depression to Franklin Roosevelt's New Deal that instituted a wide variety of new government policies, including minimum wage laws, social security, welfare programs, protection of labor unions, and farm price supports. While these programs alleviated some of the immediate hardships caused by the Depression, they prevented competitive market forces from quickly restoring prosperity and, therefore, increased human suffering.⁴ Even today, Classical Liberals believe that government regulations reduce the efficiency of the market and slow economic growth.

5. *Rational expectations.* As the economy deteriorated during the 1970s, Classical Liberal economists developed a new argument linking government intervention to economic instability. They claimed that the combined effect of government regulations and imperfections in the market creates a "natural rate of unemployment" by preventing labor markets from operating freely. Estimates of this "natural rate" are in the range of 5–6 percent, although the exact figure can increase or decrease depending on the regulatory environment. When government attempts to reduce unemployment below its natural rate by using monetary or fiscal policy to stimulate the economy, the result is inflation. Over time, individuals learn from experience to anticipate inflation whenever the government pursues expansionary policies. Based on these "rational expectations," workers demand higher wages and corporations raise prices, thereby perpetuating inflation.⁵ Economists also use the term "inflationary psychology" to describe citizens' belief that inflation will continue into the future. The

expectation of inflation becomes a self-fulfilling prophecy as workers and corporations attempt to protect their incomes by raising wages and prices.

6. *Rent-seeking*. Economist Mancur Olson (1932–1998) claimed that by restricting competitive market forces, the government allows powerful interest groups to form.⁶ These groups use their power not only to increase their income in the market but also to enlist the power of government to assist them in restructuring and manipulating the market for their own advantage. This “rent-seeking” activity consists of lobbying and financial contributions to obtain benefits such as protective tariffs, subsidies, tax breaks, and exemptions from antitrust laws. Olson argued that the power of interest groups creates “social rigidities” that suppress competition and reduce the efficiency of the market. As these groups capture the power of government in order to advance their own interests, the vitality of the market declines and economy stagnates.

Stabilization Policies

The guiding principle underlying Classical Liberal stabilization policies is confidence in the inherent stability of a market economy free from government intervention. Once the barriers to work, profitability, saving, and investment are removed by lowering taxes, reducing regulations, stabilizing the money supply, and eliminating government budget deficits, the market economy will spontaneously generate noninflationary growth and full employment. Despite a consensus among Classical Liberals that the size of government must be reduced, they propose different strategies for accomplishing that goal.

1. *Monetary rule*. Those Classical Liberals who view monetary policy as the chief source of instability want the Federal Reserve to maintain a fixed rate of growth of the money supply equal to the 2–3 percent long-run trend in real growth of the economy. To accomplish this, they have proposed an amendment to the Constitution requiring a fixed rate of monetary expansion.⁷ According to monetarists, if the money supply increases at the same rate as output, then prices should remain stable. A monetary rule would eliminate discretionary monetary policy as a tool in fighting inflation

or unemployment, but Classical Liberals believe that less inflation and unemployment would occur if businesses and consumers were confident in the stable value of the currency.

2. *Balanced budget amendment.* Classical Liberals believe that politicians will inevitably fail to balance the government's budget due to political pressures to win elections by promising voters additional benefits and lower taxes. One proposal to restrain government spending calls for a constitutional amendment requiring a balanced budget each year.⁸ Given voters' opposition to higher taxes, Classical Liberals are confident that a balanced budget amendment would result in smaller government. This strategy would eliminate discretionary fiscal policy, but Classical Liberals argue that balancing the budget would create more confidence in the economy, increase stability, and reduce the need for fiscal policy.

3. *Tax cuts.* A particular variant of Classical Liberalism called "supply-side economics" proposes tax cuts as a virtual cure-all for economic stagnation and instability.⁹ Supply-side economists gained influence during the Reagan administration, claiming that tax cuts would revive the economy by increasing the incentives for work and investment. Moreover, the increased economic activity would generate additional tax revenue to reduce the government's budget deficit. In actuality, budget deficits have grown in the wake of large reductions in taxes, but some Classical Liberals continue to advocate tax cuts as the primary tool for combating economic instability. Other Classical Liberals believe that tax cuts must be accompanied by reductions in government spending to keep the deficit from increasing.

4. *Gold standard.* Prior to the Great Depression, most industrialized nations stabilized the value of their currencies by linking the size of the money supply to the amount of gold held by the government. This system also maintained fixed exchange rates between different currencies since each remained tied to gold at a fixed price. A country that imported more than it exported would settle its debt by shipping gold to other countries. However, the gold standard came under pressure in the 1920s as Britain's

competitive position in the global economy declined, resulting in a steady decrease in its gold reserves. Speculators lost confidence in the British currency and began exchanging pound sterling for gold. As the Great Depression accelerated the depletion of the Bank of England's stock of gold, the government abandoned the gold standard in 1931, and the United States did the same in 1934. Today, some Classical Liberals, most notably members of the Austrian school, call for a return to the gold standard as an effective method to limit the power of central banks to create money.¹⁰

5. *Multiple currencies.* Friedrich Hayek suggested that the Federal Reserve's ability to create excessive amounts of money could be ended by allowing several government-commissioned private firms to issue alternative currencies. Competition between the Federal Reserve and the private firms to promote the use of their currencies would provide a strong incentive for each issuer to limit money creation because citizens would gravitate toward the currency whose value remains constant.¹¹

The Great Recession

Classical Liberals blame the Great Recession of 2008 on government intervention in the economy.¹² While agreeing that banks made imprudent loans and that Wall Street engaged in excessive risk-taking, they hold government responsible for these behaviors by creating "moral hazard." Moral hazard arises when individuals are protected from the negative consequences of their actions and, therefore, behave irresponsibly. For example, people with home insurance might not lock their doors. Similarly, banks whose deposits are guaranteed by the Federal Deposit Insurance Corporation may engage in riskier lending practices, confident that any defaults will not jeopardize the assets of their depositors. Additional moral hazard was created by two government-sponsored enterprises—the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). These privately owned organizations provide home mortgages that were guaranteed against default by the government in order to encourage increased home ownership. With no risk of default, Fannie Mae and Freddie Mac issued mortgages to home buyers with questionable credit ratings.

Classical Liberals also blame government for requiring banks to extend loans to low-income borrowers. In the past, banks routinely engaged in a practice called “redlining,” in which they refused to make loans to applicants residing in designated low-income neighborhoods. The Community Reinvestment Act of 1977 banned redlining and provided strong incentives for banks to increase their lending to disadvantaged persons.

The excessive expansion of credit, coupled with overstimulation of the economy caused by deficit spending and an easy monetary policy, created a speculative bubble in both the housing market and the stock market. As increasing number of borrowers began to default on their mortgage payments and lost their homes, housing prices began to collapse. Investors lost confidence and began selling stocks and bonds, causing the stock market to plummet. As fear gripped all market participants, banks refused to issue loans, major Wall Street investment banks failed, and several large corporations faced bankruptcy.

If Classical Liberals had controlled the political process, government would have practiced “austerity” in response to the Great Recession. Classical Liberals called for a balanced budget, tight monetary policy, and deregulation. The free market, they claim, would punish the banks, corporations, and homeowners who had taken excessive risks and establish the grounds for a rapid recovery and renewed growth. As Treasury Secretary Andrew Mellon reportedly advised President Herbert Hoover at the onset of the Great Depression: “liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate ... it will purge the rottenness out of the system.”

The severity of the Great Recession caused several prominent Classical Liberal economists to admit that their faith in free markets had been shaken. In testimony before a congressional panel in 2008, former Federal Reserve chairperson Alan Greenspan said: “those of us who have looked to the self-interest of lending institutions to [prevent instability] ... are in a state of shocked disbelief.” Two books by Classical Liberals acknowledged a “failure of capitalism.”¹³ The Great Recession marked a watershed in the history of Classical Liberalism. Although a few purists continue to defend

free markets, most Classical Liberals are now willing to concede the need for some degree of regulation to maintain stable and orderly markets.

THE RADICAL PERSPECTIVE

Causes of Instability

Radicals believe that capitalism is inherently unstable, but the causes of instability may vary over time. In 1925, the Soviet economist Nikolai Kondratiev (1892–1938) observed that capitalism experiences long-term cycles lasting 40–60 years. For each cycle, unique conditions contribute to economic expansion, but eventually obstacles to continued capital accumulation arise and a major recession ensues. After a period of stagnation, the impediments to accumulation are resolved, clearing the way for further growth. However, another recession inevitably follows as the successful resolution of one set of impediments creates conditions posing new and different obstacles.¹⁴ The following factors have contributed to the instability of capitalism since its inception: 1. *Functionality of instability*. Radicals claim that instability serves essential functions to maintain the health of a capitalist economy. Inflation diffuses class conflict by allowing both workers and owners to increase money wages and profits without increased productivity. Of course these gains are largely illusory since prices rise as well, but both sides can take satisfaction in their temporary victories. Recessions and unemployment discipline the labor force by maintaining a “reserve army of the unemployed” that creates insecurity among all workers. Recessions also eliminate the excess productive capacity caused by overly optimistic investments during the preceding boom period. Once recession lowers the costs of labor and capital, the economy stands poised for another round of expansion.

2. *Overinvestment*. Kondratiev described a 50-year cycle lasting from the 1840s to the 1890s, in which accumulation was initially promoted by the development of labor-saving technology and by the success of laissez-faire policies in abolishing the remnants of precapitalist social and political restrictions on production and trade. By the 1870s, the economies of scale

gained through mass production gave a competitive advantage to the largest firm in each industry. As competing firms vied with one another to gain dominance through expansion, they created “excess capacity.” Their combined productive capacity exceeded demand for the product, creating downward pressures on prices and profits. Much of this “overinvestment” relied on credit, so the inability to generate sufficient profit resulted in defaults on bank loans, subsequently triggering a series of banking panics and recessions in the late 19th century.

3. *Underconsumption.* Another long-term business cycle lasted from the 1890s to the 1930s. The instability of the 19th century was resolved as business leaders, realizing that “cutthroat competition” threatened the profitability of all firms, began a conscious effort to gain power over the market through mergers and acquisitions. The industrialized nations also turned to imperialism to open new markets and gain access to cheaper raw materials. Capitalism initially thrived under these conditions, but the very success of monopolization and imperialism in bolstering profits resulted in such concentrated wealth and income that the economy began to suffer from inadequate spending or “underconsumption.” Because wealthy individuals tend to save substantial portions of their income, the increasing concentration of income caused saving to rise more rapidly than consumption spending. The result was a lack of demand, cutbacks in production, unemployment, and the Great Depression.

4. *Profit squeeze.* The solution to underconsumption appeared with the advent of Keynesian economic policies. Governments supplemented inadequate spending in the private sector with additional public spending on national defense, highways, welfare programs, and space exploration. Government also boosted private spending by establishing collective bargaining for labor unions, enacting minimum wage laws, and supporting agricultural prices. However, by assuring adequate demand, government inadvertently promoted the formation of powerful interest groups such as labor unions, professional associations, and quasi-cartels in major industries. By the early 1970s, these groups used their market power to raise prices and wages, thereby creating strong inflationary pressures in the

economy. Inflation could be controlled only by maintaining a degree of slack in the economy through unemployment and slow growth.

Several other factors contributed to rising costs and declining profits during the 1970s. In 1973, the Organization of Petroleum Exporting Countries quadrupled the price of oil in retaliation for U.S. support of Israel. An expansion of government regulations imposed heavy compliance costs on corporations. Labor unions became more aggressive in bargaining for higher wages and increased benefits. At the same time, increasing competition from Japan, Germany, and low-wage producers throughout the world prevented U.S. firms from fully passing on their higher costs by raising prices. The result was a “profit squeeze” and simultaneous stagnation and inflation (stagflation).¹⁵

In response to the profit squeeze of the 1970s, Classical Liberal stabilization policies regained credibility in the form of “Reaganomics.” By pursuing a tight monetary policy, reductions in the growth of government spending, deregulation, and weakening of labor unions, the Reagan administration reduced production costs and restored profitability. During the 1990s, the combination of restrained production costs and less stringent fiscal and monetary policies led to the most prosperous decade since the 1960s. The impediments to accumulation had once again been resolved and another round of prosperity and growth ensued. By the beginning of the 21st century, however, slowing growth, stagnant wages, and increasing inequality presaged the worst recession since the Great Depression.

Stabilization Policies

In the past, many Radicals proposed socialism as the only solution to economic instability. Today, few Radicals embrace the traditional vision of socialism as government ownership of the means of production combined with centralized economic planning. Instead, they pursue institutional changes in capitalism to achieve some of the benefits of socialism while maintaining a wide range of individual freedom, property rights, markets, and democracy.¹⁶ Radical proposals for institutional changes include the following: 1. *Partial nationalization*. While Radicals acknowledge the virtues of private ownership, they suggest that economic performance may be improved by significant involvement if not ownership by government, in

particular, industries including banking, energy, communications, and transportation. These industries exhibit significant economies of scale, making them prone to domination by a few firms and therefore lacking the discipline created by competitive market forces. As a result, government regulation or ownership may be better suited to serving the public interest. For example, tighter regulation of banks might reduce the periodic speculative excesses created by profit seeking in that industry.

2. *Democratic planning.* The Soviet Union relied on centralized planning to coordinate economic activity. The government issued production targets or quotas to each firm, and managers received bonuses for meeting or exceeding the targets. By contrast, under democratic planning, the government would consult with all major interest groups to formulate a nonbinding plan for the future direction of the economy. By establishing goals for the economy as a whole, democratic planning would enable businesses to coordinate their decision making. For example, if the plan called for controlling climate change by shifting from fossil fuels to renewable energy sources, the coal industry would begin shutting down less profitable mines, while firms fabricating solar panels could confidently invest in expanding their productive capacity. Although the targets established by the plan would not be mandatory, government could encourage compliance through subsidies, tax breaks, and regulations. Critics of democratic planning point out that both Japan and France relied on this process during the 1970s and 1980s. Although their initial results appeared highly favorable, both nations encountered severe economic difficulties and reduced planning during the 1990s. Radicals claim that the question remains open as to whether problems in Japan and France arose from planning or from other causes.

3. *Socialization of investment.* The decisions of private investors are typically guided by a single criterion: short-term profit maximization. This criterion fails to create an efficient allocation of investment funds because it does not take into account the external costs and benefits created by different investment projects. For example, investments in the coal industry occur without consideration of potentially catastrophic climate change caused by fossil fuels. Moreover, private investment often exacerbates

instability by occurring in spurts. In a strong economy, investors are optimistic, leading to excessive investment that spurs inflationary pressures. Conversely, during a recession, widespread pessimism dampens investment and makes recovery even more difficult. To address both these problems, Radicals propose some degree of government control over the amount and direction of investment. This socialization of investment could take the form of direct investment by government in infrastructure such as highways and schools, selected investment by government in targeted industries, or incentives offered by government either to accelerate or to slow private investment during different phases of the business cycle. As an example, the Swedish government has experimented with allowing corporations to place profits in tax-sheltered investment funds requiring government approval before the funds can be tapped for investments in physical capital. Approval would presumably be given when the economy slows and additional investment is needed.

4. *Coordinated collective bargaining.* When workers and unions in each firm or industry bargain separately with their employers, they are seeking maximum gains in wages and benefits. Union members may feel no constraint in demanding higher wages because each union forms a relatively small part of the economy and its gains may not significantly affect inflation. However, when all labor groups bargain aggressively but separately for maximum wage increases, inflationary pressures develop. Radicals propose to control inflation by establishing nationwide collective bargaining, wherein representatives of many different labor unions negotiate with representatives from a variety of industries. This coordinated bargaining process would accomplish a dual purpose. First, unions might become more socially responsible in their wage demands, realizing that inflation and job loss are contrary to their interests. Second, employers can accommodate justifiable increases in wages without losing competitive advantage to rival firms. Ideally, wage increases should fully reflect increases in productivity without being so excessive as to cause inflation.

5. *Redistribution.* Radicals believe that capitalism becomes more unstable as the ownership of productive resources is concentrated in fewer hands. Concentrated wealth creates vast pools of financial capital that may

exceed profitable investment opportunities in the production of goods and services. Instead, this money flows into speculative assets such as real estate, precious metals, and collectibles that do nothing to improve the productive capacity of the economy. Speculation leads to asset inflation or “bubbles,” which usually burst, leading to recession. Concentrated wealth also deprives the majority of the population of sufficient disposable income to engage in the level of consumer spending required to sustain a thriving economy. Radicals propose to achieve a more balanced pattern of ownership of productive assets through employee stock ownership plans (ESOPs) and government programs to encourage the formation of worker-owned businesses.

The Great Recession

Radicals claim that globalization has revived the problems of both overinvestment and underconsumption.¹⁷ The increasing integration of national economies into a single global market creates excess capacity. In the steel industry, for example, as companies throughout the world began competing directly with one another, productive capacity exceeded global demand, and falling prices resulted in the closure of many steel mills. Globalization has also eroded many of the institutions established since the 1930s to reduce income inequality and maintain high levels of consumer spending. For example, in a global labor market, labor unions lose much of their bargaining power to secure wage increases. Similarly, international competition creates pressures on government to reduce taxes which, in turn, forces cutbacks in welfare programs.

With wages remaining stagnant throughout much of the world, nearly all of the recent productivity gains from technological advances have gone to owners of capital. Inequality in the distribution of income and wealth has now reached levels not seen since the late 1920s just prior to the Great Depression. Since wealthy individuals typically save a substantial portion of their income, this increasing inequality results in a global “savings glut” and corresponding underconsumption. Excess savings create a pool of financial capital sloshing around the globe in search of profitable investment opportunities. To absorb this tsunami of capital, Wall Street banks developed new and complex financial assets, essentially allowing

investors to gamble on the performance of other assets. Leading up to the Great Recession, many of these “collateralized debt obligations” were backed by home mortgages, so when the real estate bubble began to burst in 2007, panic ensued in financial markets, and the entire global economy was at risk.

Governments around the world responded to the Great Recession with bailouts and stimulus programs, but Radicals view these policies as only temporary solutions to instability. Globalization has unleashed the market from many of the stabilizing constraints imposed by national governments, and so, in the absence of new regulations, the 21st century may witness a return to the instability of the late 19th and early 20th centuries. Since national governments have lost much of their power due to the mobility of capital, Radicals propose global governing institutions to harness the dynamic but potentially destabilizing forces of the market. The mobility of capital could be reduced with a tax on all financial transactions, including currency exchanges. Uniform banking regulations across nations would limit the risky investments and speculation that fuel asset bubbles.

Radicals believe that without massive government stimulation of the economy, the Great Recession might have rivaled the Great Depression or worse. In 2008, the U.S. Congress authorized \$700 billion of additional government spending to purchase “toxic assets” held by banks and other private firms, although only \$475 billion was actually spent. Between 2009 and 2014, the Federal Reserve engaged in “quantitative easing” by creating approximately 3 trillion dollars of additional money. For Radicals, the fact that the economy has been slow to recover despite this historically unprecedented stimulus indicates how devastating the recession might have been if the government had not intervened.

According to Radicals, the global combination of excess productive capacity and inadequate demand will continue to create downward pressure on prices and profits. Japan has been plagued by deflation and stagnation for the past two decades, and European nations appear to be facing similar problems. Deflation can be just as dangerous as inflation because the prospect of falling prices causes consumers and businesses to delay purchases, thereby reducing demand even further. With growth slowing in other major economies such as China, Russia, and Brazil, the prospects for the global economy remain dim. Even if another major recession can be

avoided, slow growth, rising inequality, and high unemployment may become the new norm.

THE CONSERVATIVE PERSPECTIVE

Causes of Instability

The Austrian/American economist Joseph Schumpeter (1883–1950) attributed business cycles to waves of technological innovation periodically sweeping through the economy.¹⁸ For example, the development of both the railroad and automobile industries required massive investments that stimulated economic growth. As the products and technologies developed by innovators are copied by less competent imitators, the market becomes saturated, profitability declines, investors become pessimistic, and a recession begins. Schumpeter viewed recessions as unavoidable and actually useful in accomplishing what he called “rubbish disposal.” The weakest firms must liquidate excess capacity and lay off less productive workers or possibly go out of business. Like storms that trim dead wood from trees, recessions maintain the health of the economy and set the stage for renewed growth and prosperity.

For most Conservatives, however, economic instability is symptomatic of the following trends in social, cultural, and political institutions: 1. *Decline of community and family.* Conservatives believe that markets function well only when they are embedded in an institutional framework based on traditional values and hierarchical authority.¹⁹ In the 19th century, Conservatives worried that capitalist industrialization endangered communities by encouraging individualism, mobility, and the pursuit of material self-interest. As individuals began to view themselves as independent entities capable of defining and pursuing their own interests, they challenged traditional sources of authority such as the church, the state, and local elites. Without traditions and authority, the struggle for wealth and power manifests itself in the form of economic instability.

Communities provide humans with the collective wisdom and guidance essential to a stable society. People form their personal identities and find meaning and purpose within these social contexts. Socially isolated individuals focus on self-interest and are less likely to direct their energies toward meaningful involvement in family, church, and community.

Schumpeter expressed concern that men and women would not reproduce if they based the decision solely on calculations of the costs and benefits of raising children. He suggested that parents might ask themselves the question: “Why should we stunt our ambitions and impoverish our lives in order to be insulted and looked down upon in our old age?”²⁰ The Conservative critique of capitalism overlaps with the Radical perspective insofar as both stress the role of communities in nurturing and guiding human behavior. However, while Radicals propose to transcend capitalism, Conservatives defend precapitalist institutions such as church and family as necessary to maintain a stable capitalism.

2. *Decline of morality.* As communities disintegrate, individuals increasingly rely on their own calculations of costs and benefits in moral choices. As a result, any notion of objective values is replaced by moral relativism, leaving individuals free to form their own values and act accordingly. In the absence of strong community bonds and religious beliefs, the pursuit of material self-interest overrides values such as honesty, responsibility, integrity, loyalty, and empathy. Business owners pursue maximum profit without regard for their local communities, workers shirk their duties, and all citizens become increasingly focused on immediate gratification of desires. As individuals experience difficulty in finding meaning and purpose, they become bored, anxious, and depressed, resulting in higher rates of substance abuse, divorce, violence, and suicide coupled with declining commitment to family, community, religion, and country. A nation lacking a strong moral compass provided by religion or shared values lacks the cohesiveness to maintain stability and order.²¹

3. *Unrestrained democracy.* In the 19th century, Conservatives tended to oppose any extension of voting rights beyond male property owners. They feared that majority rule would upset the natural hierarchy as the more numerous members of the lower classes voted to confiscate property and power from the upper classes. However, by the 20th century, Conservatives accepted a limited form of democracy. Schumpeter claimed that a democratic political system should meet the following prerequisites. First, political leaders should come from the upper classes since their education

and financial independence enable them to remain impartial in promoting the public interest. Elections should be simply competition among elites to determine who will lead the nation. Second, to insulate government from the influence of interest groups, the range of discretion and responsibility given to elected politicians should be limited, leaving the details of the governing process to professional bureaucrats. Finally, all groups in society, including politicians, must exercise what Schumpeter called “democratic self-control.” Interest groups should not attempt to use government to gain benefits, and politicians should have the integrity to resist such efforts.²²

Conservatives argue that the conditions essential for a healthy democracy have been steadily eroding in modern societies. The disintegration of traditional communities and the weakening of moral standards result in bitter conflicts over individual rights and rewards. To gain advantage in these conflicts, individuals form interest groups such as labor unions, professional associations, and manufacturing groups. On one hand, Conservatives applaud the formation of groups to promote a sense of identity, belonging, and purpose. But in order to preserve a stable and harmonious society, these groups must operate within the context of a broad social consensus that restrains selfishness. When each group focuses only on self-interest, the public interest is sacrificed and politics descends into a clash of opposing interests rather than a collective effort to improve society.

The market power of interest groups enables them to raise prices, and the resulting inflation creates destabilizing social and psychological effects. Inflation breeds insecurity and anxiety by creating uncertainty about the future and by changing the value of assets. The virtues of hard work and thrift weaken as inflation rewards debtors and spenders for their profligacy. The work ethic erodes as individuals increasingly attempt to profit from inflation through speculative activities such as investments in real estate and gold. Since some groups benefit from inflation while others suffer, the resulting resentment and animosity contribute to social disorder.

Unrestrained democracy has led to the welfare state as government doles out benefits to various groups in order to attract voters and win elections. The welfare state effectively destroys the dynamism of modern societies by fostering laziness, dependency, and a vast government bureaucracy. As the role of government expands, it undermines the broad array of “mediating

structures” such as family, church, and neighborhood that provide individuals with identity and self-discipline.²³ For Conservatives, the problem of economic instability is a symptom of the cultural transformations associated with industrialization and modernization.²⁴

4. *Crony capitalism*. Conservatives believe that unrestrained democracy renders government vulnerable to the power of interest groups. Politicians increasingly seek reelection by granting favors in exchange for campaign contributions. Those groups with sufficient funds to “pay to play” are rewarded with subsidies, grants, tax breaks, deregulation, privatization, and lax enforcement of existing regulations. The combination of increased government spending and reduced taxes leads to growing budget deficits that create inflationary pressures and destabilize the economy.

Stabilization Policies

Conservatives join with Classical Liberals in opposing activist government policies aimed directly at stabilizing the economy. They support a balanced budget amendment to the Constitution, a monetary rule to eliminate the Federal Reserve’s discretion over the size of the money supply, and the elimination of many government regulations. However, unlike Classical Liberals, Conservatives do not have faith in the free market unless it is embedded in appropriate social, cultural, and political institutions. They propose the following reforms to create those institutions:

1. *Community revitalization*. As industrialization was destroying traditional communities during the 19th century, the French sociologist Emile Durkheim (1858–1917) proposed that uprooted and alienated workers might form new communities based on their occupations.²⁵ Since that time, Conservatives have stressed the importance of reforming communities to supplement the small towns and villages that once provided havens from the impersonal forces of markets and government. However, Conservatives have had difficulty in developing strategies for community revitalization. They remain reluctant to depend on government since they partially blame the expansion of government for eroding communities by taking over many of their functions. However, they do look to government to enact pro-family policies such as lower taxes for married couples, larger tax deductions for

dependent children, and stricter divorce laws. Conservatives anticipate that the decay of modern societies will eventually motivate frustrated citizens to regain local control of communities in order to reestablish traditional culture, control crime, promote religion, and revive cohesive neighborhoods.

2. *Cultural renewal.* On economic issues, Conservatives typically join with Classical Liberals in opposing direct government intervention such as monetary and fiscal policies. However, Conservatives believe that economic issues are inextricably linked with cultural changes, and they look to government to protect traditional culture from the corrosive forces of modernization. Conservatives favor tight restrictions on immigration and insist on preserving the traditional meaning of marriage by banning marriages between same-sex individuals. To promote religious devotion, Conservatives favor school prayer and the display of religious symbols in public spaces. Culture should be protected from indecency by banning pornography and violent entertainment.

3. *Limited democracy.* Conservatives join with Classical Liberals in calling for a strict interpretation of the Constitution in order to limit the discretionary power of government. They support term limits to political office so that politicians will focus on promoting the public interest rather than gaining reelection. Schumpeter went so far as to suggest that socialism with limited democracy might perform better than capitalism with unrestrained democracy. Government bureaucrats insulated from democratic pressures might be better suited to promoting the public interest than capitalists focused on short-term profit maximization. However, this Conservative version of socialism would require that citizens have little direct input into the political process.

4. *Corporatism.* Some Conservatives, particularly those in Europe, propose to limit pressure from interest groups on government by organizing society into associations. For example, each industry and each occupation might have its own association, with an overarching structure to integrate and coordinate the interests of each group. Rather than being the tool of interest groups, government would control the associations by appointing

leaders and mediating conflicting demands. This system of “state corporatism” bears some resemblance to fascism without violence, war, and genocide. Several proposals for state corporatism have appeared. During the 1970s, Henry Ford II established the Initiative Committee for Economic Planning to explore strategies for cooperation among government, business, and labor to develop broad goals for the future of the economy. In 1971, David Rockefeller organized the Trilateral Commission consisting of 180 members from North America, Western Europe, and Eastern Asia.²⁶ The Conservative nature of the Trilateral Commission was evidenced in its concern that government be insulated from what it called “an excess of democracy.” The Commission proposed greater autonomy for the executive branch of government and suggested that the president’s term of office be lengthened from four to eight years.

The Great Recession

For Conservatives, the recession of 2007–2009 reflected the culmination of trends that had been forming for decades. The combination of unrestrained capitalism and unrestrained democracy eroded the foundations of a free society by replacing stability and order with conflict among self-interested individuals and among powerful interest groups. Conservatives blame nearly everyone for contributing to the Great Recession. Government disrupted the natural order with welfare programs, deficit spending, excessive money creation, and guaranteed mortgages. Individuals and businesses were guilty of greed and selfishness. Consumers purchased homes they could not afford and used credit cards to acquire more material possessions. Banks and Wall Street investment firms engaged in fraud and deceit in the single-minded pursuit of profit. Conservatives expect that without a revitalization of culture and community, an economy without a firm moral basis will continue to experience instability.

THE MODERN LIBERAL PERSPECTIVE

Causes of Instability

Modern Liberals share with Radicals the belief that an unregulated capitalist economy is inherently unstable. The Modern Liberal analysis of inflation and unemployment relies on the economic theory developed by John Maynard Keynes during the Great Depression.²⁷ During the next four decades, Modern Liberals felt confident that Keynesian economics provided the knowledge and tools to minimize instability. However, that confidence was shattered by the “stagflation” of the 1970s that proved to be impervious to Keynesian solutions. Modern Liberals attribute instability to the following causes: 1. *Animal spirits*. Keynes claimed that the volatility of investment spending, and hence instability in the overall level of economic activity, is partly explained by changes in the psychological moods of investors. He used the term “animal spirits” to describe the human emotions and instincts that create “a spontaneous urge to action.”²⁸ When investors become optimistic and confident about the future of the economy, they eagerly fund risky new projects. During an economic boom, animal spirits may override careful calculations of risk, leading to overinvestment and resulting excess capacity. As profitability begins to decline, fear and pessimism dampen the animal spirits as investors become cautious and reluctant to engage their financial capital.

2. *Excessive inequality*. Keynes also believed that excessive inequality in the distributions of wealth and income contributes to recessions. Since wealthy households spend a smaller portion of their income on goods and services, growing inequality tends to suppress consumer spending. As business inventories of unsold goods accumulate, investors grow pessimistic about future profitability and investment spending declines as well. Unless increased government spending compensates for the decline in consumption and investment, the economy will almost certainly contract.

3. *Market power*. Modern Liberals attribute the stagflation of the 1970s to the formation of a “dual economy” composed of two sectors. The primary sector, consisting of large corporations, professional associations, and labor unions, remains relatively insulated from competitive market forces and, therefore, gains “market power” to increase income by raising

prices and wages. The secondary sector, composed of small businesses, nonunionized workers, and farmers, continues to operate in competitive markets and, therefore, has little control over prices or wages. Using Keynesian policies, government could not suppress the inflation emanating from the primary sector without slowing the economy and causing unemployment in the secondary sector. Government was forced to settle for an unsatisfactory compromise of simultaneous inflation and unemployment. The inability to combat stagflation seriously discredited Modern Liberalism in much the same way that Classical Liberalism had been tarnished by its failure to cope with the Great Depression.

4. *Lack of regulation.* Modern Liberals view government regulations as necessary to compensate for failures of the free market. Financial markets in particular are prone to instability due to the uncertainty surrounding most investment decisions. Lacking full information about the risks associated with different investments, investors rely on their instincts and moods. Waves of optimism or pessimism lead to “herd behavior” as investors seek to be the first to enter a bull market and first to exit a bear market. With investors’ behavior governed by fear and greed, financial markets exhibit wild volatility, which can easily lead to fluctuations in the real economy.

5. *Globalization.* Modern Liberals agree with Radicals that globalization has caused renewed instability by eroding many of the policies and institutional constraints designed to tame the business cycle. For example, the ability of government to stimulate the economy with additional spending may be offset by declining exports due to rising prices. Lowering interest rates to stimulate the economy by encouraging borrowing may cause an outflow of financial capital as investors pursue higher rates of return abroad. Globalization has created competitive pressures on governments to reduce regulations in order to prevent businesses and money from relocating to other countries.

Stabilization Policies

During the four decades between the Great Depression and the stagflation of the 1970s, Modern Liberals relied on fiscal and monetary

policy to control the business cycle. Stabilizing the economy was analogous to driving a car—expansionary policies (i.e., more government spending, lower taxes, or additional money creation) were like pressing on the gas pedal, while contractionary policies (i.e., less government spending, higher taxes, or reductions in the money supply) could be compared to stepping on the brakes. Through “demand management,” government could control the amount of spending in the economy to offset any deficiency or excess in private spending on consumption and investment. Recessions could be prevented by stepping on the gas as soon as the economy showed any sign of weakness, and inflation could be halted by applying the brakes.

Because stagflation entailed simultaneous inflation and recession, it could not be solved using only fiscal and monetary policy. Government policy makers could not step on the gas and the brakes at the same time. While Modern Liberals continue to support the use of monetary and fiscal policy, the experience of stagflation in the 1970s caused them to develop additional policies to stabilize the economy.

1. *Increased regulation.* Some Modern Liberals suggest that government can control inflation by establishing guidelines for wage and price increases. Economists Sidney Weintraub (1914–1983) and Henry Wallich (1914–1988) proposed a “tax-based incomes policy” to impose tax penalties on businesses that raise wages or prices in excess of government guidelines. Businesses conforming to the guidelines would receive tax rebates from the government. A similar proposal by economist Abba Lerner (1903–1982) called a “market-anti-inflation plan” would require firms to bid for government licenses if they planned to increase prices and wages faster than the average rate of growth of productivity in the economy. Modern Liberals also seek tighter regulation of the financial sector due to its inherent instability. Requirements for transparency and full disclosure of information would reduce the speculative excesses that fuel asset bubbles and subsequent crises. For the economy as a whole, stricter enforcement of antitrust laws would reduce the market power that contributes to inflation.

Modern Liberals generally support globalization, but they claim that new regulations are needed to prevent rapid flows of financial capital between countries from destabilizing the economy. Economist James Tobin (1918–2002) proposed a tax on all exchanges of assets from one currency to

another to discourage currency speculation. Some Modern Liberals have broadened this proposal to call for a tax on all financial transactions, including purchases of stocks and bonds. Other Modern Liberals favor the renewal of “capital controls” that limited flows of financial capital across national borders in the decades following WWII.

2. *Public investment.* Government spending stimulates the economy by increasing aggregate demand. However, when market power exists in the private sector, the additional demand creates inflationary pressures long before the economy reaches full employment. To solve this problem, Modern Liberals increasingly advocate government spending on physical and social infrastructure such as highways, bridges, education, and health care. While these public investments create additional demand, they also increase aggregate supply by improving productivity and reducing business costs. With both supply and demand increasing, the economy can expand without inflation. Modern Liberals acknowledge that higher taxes are needed to finance large public investments, but they argue that the economy was performing relatively well during the decades after WWII when the highest marginal income tax rate was 91 percent in the 1950s and 70 percent in the 1960s.

3. *Manpower policy.* In an age of increasing technological sophistication, maintaining high rates of employment requires a well-trained labor force. Yet, corporations hesitate to provide on-the-job training in general skills due to the potential loss of employees to rival firms. Based on calculations of costs and benefits, corporations often hire new employees already possessing the needed skills rather than retrain current employees. However, these decisions do not take into account the social costs created by layoffs in terms of community dislocations, crime, welfare, substance abuse, and the disintegration of families. Modern Liberals propose to upgrade the quality of the labor force with increased funding for public education, tax credits for educational expenses, closer links between academic and vocational studies, and tax breaks or subsidies to corporations for retraining employees.²⁹

4. *Industrial policy.* During the 1980s, many prominent Modern Liberals advocated the adoption of “industrial policy” in which government would actively promote growth and development by providing stimulus to particular industries judged to be essential to future success in the global economy.³⁰ Stimulus could take the form of subsidies, tax breaks, low-interest loans, or funding for research and development. Critics of industrial policy claim that the stock market is better suited than government for picking “winners” and “losers.” In response, Modern Liberals propose matching loans or grants to firms and industries attracting private capital, leaving the selection of “winners” to the private sector with government providing an additional boost to support growing industries. Industrial policy has fallen out of favor since Japan, its leading practitioner, encountered severe economic difficulties beginning in the early 1990s. However, Modern Liberals continue to believe that government can play a positive role in supplementing the market’s allocation of financial capital.

5. *Greater equality.* Modern Liberals acknowledge that economic inequality may have served a purpose in the 19th and early 20th centuries when large pools of savings were necessary to fund investments in physical capital. But in the 21st century, the development of human capital in the form of knowledge and skills is the key to economic growth and development. No society can be successful while allowing a considerable portion of its potential human talent to remain untapped. Greater equality of income and wealth provides opportunities for all citizens to fully develop their talents and abilities. Increased equality also boosts consumer spending and discourages the formation of excess financial capital that leads to speculation and destabilizes financial markets.

To achieve greater equality, Modern Liberals propose redistribution of income. The most direct methods for accomplishing this goal are taxation and the provision of social benefits through welfare programs. Modern Liberals favor increasing the progressivity of the income tax and the estate tax while providing relief to low-income households through food stamps, subsidized housing, Medicaid, free school lunches, and other forms of welfare. However, Modern Liberals acknowledge that public support for direct redistribution is weakened by the popular belief that income should

be tied to productive activity. To make redistribution more politically acceptable, Modern Liberals rely on various regulations such as minimum wage laws, earned income tax credits, antidiscrimination laws, and agricultural price supports to achieve greater equality in the market's distribution of income.

The Great Recession

While Classical Liberals attribute the Great Recession to government mismanagement of the economy, Modern Liberals find fault with the behavior of nearly all parties in the financial services industry.³¹ Wall Street banks and brokerage firms engaged in dishonesty, deception, and irresponsible risk taking. Bond-rating agencies such as Moody's and Standard and Poor's provided inaccurate assessments of the creditworthiness of various financial assets in return for increased business from Wall Street.³² Banks and mortgage brokers issued loans to applicants clearly lacking the financial means to make monthly payments, basing their decisions on the expectation that a repossessed house would be worth more than the remaining balance on an unpaid mortgage.

Modern Liberals expect that unregulated market participants will behave in socially irresponsible manners. They claim that the deregulation of financial markets engineered by Classical Liberals beginning in the 1980s set the stage for the Great Recession. In particular, the 1999 repeal of the Glass-Steagall Act, passed in 1933 to prevent commercial banks from investing in the stock market, allowed the entire financial sector to take on greater risk. Moreover, to evade existing regulations, banks and brokerage firms developed new types of financial assets traded in a "shadow market" outside the scrutiny of the Securities and Exchange Commission or the Commodities Futures Trading Commission.

Modern Liberals agree with Radicals that globalization and increasing inequality created the underlying forces leading to the Great Recession. Rather than blaming consumers for excessive borrowing and debt, Modern Liberals point to the predatory lending practices by which banks sought new customers for the excess financial capital resulting from inequality. Consumption spending was sustained by allowing households to go deeper into debt, but eventually the "house of cards" collapsed.³³ Inequality also

contributed to the Great Recession by increasing the political power of the wealthy. With nearly unlimited funds at their disposal for lobbying and engaging in other forms of political influence, Wall Street bankers and the entire financial sector were able to persuade Congress to deregulate their activities.

In the wake of the Great Recession, Modern Liberals strongly opposed Classical Liberals' proposals to practice "austerity" by balancing the government's budget, tightening the money supply, and further deregulating the economy.³⁴ Modern Liberals called for renewed regulation in the form of the 2010 Dodd–Frank Wall Street Reform and Consumer Protection Act. However, due to continued lobbying by the financial industry, many of the more stringent provisions in the act were eliminated before passage. Modern Liberals also supported massive increases in government spending, including the \$700 billion authorized for the purchase of "toxic assets" held by banks and other firms. Another Modern Liberal policy to recover from the recession was the "quantitative easing" conducted by the Federal Reserve to pump 3 trillion dollars of new money into the economy.

From the Modern Liberal perspective, the fact that the economy has been slow to recover from the Great Recession indicates that the increases in government spending and the money supply were too small. Since inflation remains dormant, they argue, the economy needs continued stimulus in the form of expansionary fiscal and monetary policies. Modern Liberals believe that without continued stimulus, the potential for deflation poses a more serious threat than inflation. With deflationary pressures prevalent throughout the world, now is the time to pursue a goal of full employment through continued low interest rates and large public works projects to rebuild and improve physical and social infrastructure.³⁵

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Chapter 9

Poverty and Inequality

The persistence of poverty amid affluence is one of the most troubling aspects of contemporary societies. During the “Gilded Age” of the late 19th century, the original vision of the United States as a land of equal opportunity began to erode as massive accumulations of wealth coexisted with urban slums and rural hardship. After the Great Depression, governments around the world increased their efforts to combat poverty and inequality. Yet, despite the expansion of the welfare state and progressive taxation, the current distribution of income in the United States does not differ significantly from that of the 1920s. A decline in inequality during the decades following WWII has been reversed by growing inequality since the late 1970s. Currently, half the national income goes to the top 20 percent of households, and the top 1 percent of households receives 23 percent of national income. In contrast, the poorest 20 percent of households receive just 3 percent of income.¹ Wealth is even more unequally distributed, with the top .1 percent (10th of 1 percent) of households holding 22 percent of the nation’s private wealth. The incidence of poverty remains stubbornly high at about 15 percent of households. In this chapter, we examine some of the central questions concerning poverty and inequality. What causes inequality? Is inequality good or bad for

society? Should government attempt to change the distribution of wealth and income?

THE CLASSICAL LIBERAL PERSPECTIVE

Explanations of Inequality Classical Liberals attribute inequality in the distribution of income to the following factors: 1. *Ownership of assets*. The productive assets or factors of production (e.g., land, labor, capital, and entrepreneurship) owned by each individual vary in quantity and quality. Some land is more fertile or better situated, some individuals possess unique talents, skills, or knowledge, some machinery is more productive, and some entrepreneurs are more innovative and farsighted. In theory, the free market rewards owners in accordance with the contribution of their assets to the production of goods and services valued by consumers. This claim was formalized in the late 19th century by U.S. economist John Bates Clark (1847–1938). His “marginal productivity theory” of income distribution demonstrated that in a perfectly competitive market, each factor of production earns an amount equal to the value of its marginal product (i.e., the additional value created by the last unit of that factor used in production). Employers will utilize additional units of each factor of production as long as the value of the marginal product is greater than the cost. Due to the law of diminishing returns, the value of the marginal product of a factor declines as more of it is used. Therefore, at some specific level of utilization, remuneration is just equal to the value of the marginal product. Employers maximize profit when they operate at this level, and income will be distributed according to the quantity and quality of economic resources offered in the market by each person. While Clark’s theory may explain the distribution of income, it accepts the distribution of assets (wealth) as given and offers no justification for the latter.

To deal more specifically with the distribution of wages and salaries, economists have developed the concept of “human capital” to describe individual attributes contributing to productivity.² Individuals invest in human capital through education, vocational training, and other forms of acquiring skills and knowledge. As individuals gain more human capital, their income from labor should increase. Classical Liberals conclude that

low incomes and poverty are largely explained by individuals' lack of productive assets, including not only land, physical capital, and entrepreneurship but also human capital.

2. *Individual preferences.* Individual preferences affect the distribution of wealth and income in two ways. First, the preferences of consumers influence the value of productive assets. A shift in consumer tastes may cause the value of some resources to rise and others to fall. In addition, preferences affect how much time, effort, and money individuals devote to developing and improving the quality of their productive assets. For example, possessing a college degree may increase the value of an individual's labor, but first the choice must be made to pursue a degree. In short, even if all individuals had similar innate abilities, inequality would result from their different choices to develop and use them. People who invest their time, money, and energy in developing productive assets will receive higher incomes, while those who prefer leisure, avoid risk, and fail to plan for the future will fall behind. From the Classical Liberal perspective, success or failure depends on the choices people make throughout their lives. Poverty is the result of choices made by people who value leisure more than the income gained through work. Those who choose not to acquire productive assets will have little to exchange for income in the market.

3. *Technology.* Like individual preferences, changes in technology can render previously valuable assets obsolete and, therefore, change the distributions of wealth and income. The introduction of large-scale production in the 19th century drove many smaller firms out of business and contributed to the concentration of wealth. The computer revolution has created intense demand for employees with advanced technical knowledge while eliminating many routine jobs. As a result, salaries of professional and technical employees have been rising, while wages for less-skilled workers remain stagnant. Technological developments in music, film, sports, and publishing have created a global market in which only a few superstars succeed. Before radio and television broadcasting, local talents could prosper by practicing their art. However, with mass media connecting all corners of the globe, a small number of actors, athletes, writers, and

musicians earn millions of dollars each year, while many others barely eke out a living. The same trend is observable in other industries such as computer software, banking, and retail sales. This “winner-take-all” economy is the result of technological change.³

4. *Government intervention.* J. B. Clark’s marginal productivity theory assumes perfect competition, but Classical Liberals acknowledge that competition is often limited. However, they attribute many market imperfections to government intervention. For example, unemployment is exacerbated by minimum wage laws that prevent individuals from competing for jobs by offering to work for less than prevailing wages.⁴ If all welfare programs were abolished, more people would choose to work and poverty would diminish. More generally, Classical Liberals claim that interest groups including corporations, labor unions, and professional organizations engage in “rent-seeking” by persuading government to manipulate and regulate markets to their advantage. Competition in a free market would eliminate the protections and privileges secured by powerful interest groups with the aid of government. Classical Liberals believe that a free market would generate less inequality and poverty than the current regulated markets prevailing throughout the economy.

Arguments for Inequality During the transition from feudalism to capitalism, Classical Liberals stood at the forefront of efforts to demolish the privileges and hierarchy associated with medieval society. The Enlightenment offered a vision of society in which distinctions of class, race, religion, or nationality would have no effect on social mobility. Enlightenment thinkers defended the basic natural equality of all persons and assumed that ridding society of obsolete institutions would result in a more balanced distribution of income and wealth. This strong egalitarianism became most evident in France, while English social theorists expressed doubts about the natural equality of human beings. John Locke, for example, suggested that workers were less rational than members of the upper class.⁵ None of the early Classical Liberals advocated voting rights for women or for men without property. Thus, despite its roots in the egalitarian spirit of the Enlightenment, Classical

Liberalism began to justify inequality at an early stage in its evolution.⁶ The Classical Liberal defense of inequality is based on the following points: 1. *Freedom*. According to Classical Liberals, if individuals are free to choose, inequality will inevitably arise among persons with different abilities and different preferences for work, saving, and risk-taking. Inequality is inextricably linked with freedom, and efforts to suppress inequality require expansion of governmental power and a corresponding reduction of freedom. Government would either have to restrict what Robert Nozick called “capitalist acts between consenting adults” or else redistribute the income resulting from these transactions.⁷ In either case, freedom would be curtailed.

Milton Friedman claimed that inequality provides a bulwark against government oppression of citizens. The accumulation of wealth in private hands creates “foci of power” throughout society that can challenge the political power of government.⁸ For example, ideas or innovations unpopular with the government can still gain financial support when some individuals have substantial wealth at their disposal.

2. *Justice*. Classical Liberals view inequality resulting from competitive market transactions as fair and just.⁹ Some individuals receive more money than others, but they may also have incurred substantial costs in terms of advanced education, stress, and risk-taking. Economists use the term “compensating wage differentials” to describe the greater rewards for jobs with higher training costs, greater levels of responsibility, and greater risk. When all the advantages and disadvantages of different occupations are considered, individuals are more nearly the same in their well-being than their relative wage levels would indicate.

Echoing J. B. Clark’s marginal productivity theory, Friedman claims that a market society is fair because each person is rewarded “according to what he and the instruments he owns produces.”¹⁰ However, other Classical Liberals such as Friedrich Hayek make no claims about the justice of a market economy.¹¹ Hayek acknowledged that chance, both in genetic endowments and in discoveries of profitable opportunities, plays a significant role in determining individual success. Moreover, reliance on the marginal productivity theory to demonstrate the justice of markets assumes

a “productivity ethic” linking rewards with productive contributions. While productivity would probably be high on any list of criteria of justice, there are alternative criteria such as individual needs or rights, and society has no objective method for choosing among them. Hayek referred to justice as a “mirage” and defended markets based on their capacity to protect individual freedom and promote economic efficiency and growth.

3. *Efficiency*. According to Classical Liberals, inequality establishes powerful incentive for productive behavior. Much of human activity is motivated by the knowledge that effort, risk-taking, and innovation can result in material gains and upward social mobility. Opportunities to advance and the visible presence of luxurious lifestyles stimulate desires and unleash human energy. Adam Smith referred to this admiration of wealth as a “deception which rouses and keeps in continual motion the industry of mankind.”¹² Another link between inequality and efficiency arises from increased productivity gained through a hierarchical division of labor. From the Classical Liberal perspective, efficiency in production requires that a relatively small number of people have authority over the productive activity of others. Since greater rewards are attached to higher positions in the hierarchy, inequality inevitably results from efficiency in production.

4. *Growth*. Classical Liberals believe that economic growth requires a substantial amount of saving in order to provide funds for investment in expanding productive capacity. Since only relatively wealthy households can be expected to save large portions of their income, concentrations of wealth promote growth and, therefore, benefit all citizens. Efforts by government to promote greater equality by redistributing income from rich to poor reduce saving and investment, slow economic growth, and eventually harm both rich and poor. Classical Liberals reject the Keynesian claim that too much saving harms the economy, arguing that more saving increases the supply of funds available for lending, drives down interest rates, and stimulates more borrowing and investment.

Responses to Poverty

Early Classical Liberals such as Thomas Malthus claimed that poverty was the direct consequence of the human propensity to overpopulate a world containing limited fertile soil with which to grow crops. Malthus opposed any government actions to alleviate poverty because assistance would only encourage additional population growth and further misery. However, as the role of government in the economy expanded in the 20th century, Classical Liberals began to argue that poverty was caused by misguided government policies that prevent the market from operating freely. They also realized that chronic poverty threatened to undermine public support for free markets. In light of these concerns, they now defend the following solutions to poverty: 1. *Economic growth*. Using the slogan “a rising tide lifts all boats,” Classical Liberals claim that economic growth is the surest remedy for poverty. Growth creates opportunities for jobs, entrepreneurship, and upward mobility. Unlike welfare programs using taxpayer dollars to assist the poor, growth creates a “win-win” situation in which everyone can prosper. For Classical Liberals, the best way to promote economic growth is to allow markets to operate freely by minimizing taxes and regulations.

2. *Reductions in welfare*. Classical Liberals believe that welfare benefits actually create poverty.¹³ If individuals receive money without working, then more individuals will choose not to work. Welfare creates dependency as recipients lose self-esteem and self-reliance. Over time, welfare recipients become unemployable as they fall into lifestyles devoid of responsibilities and motivation. Cuts in welfare benefits would help impoverished citizens develop the initiative to regain control over their lives and lift themselves out of poverty. Welfare should also be restricted by making eligibility requirements more stringent. For example, recipients should be required to enroll in educational programs or participate in “workfare” by performing public sector jobs such as picking up litter or raking beaches. Finally, Classical Liberals condemn welfare programs for fueling class tensions as taxpayers resent the poor who receive money without making productive contributions to society.

3. *Private charity.* Whereas funding for welfare benefits is extracted from taxpayers through the coercive power of government, charitable donations by citizens are freely given and, therefore, consistent with individual liberty. While Classical Liberals approve of private charity, they caution that aid should be minimal so as to retain the incentive to work. Like welfare, charity can encourage irresponsible behavior. Ideally, charity would be given through local organizations such as churches or civic clubs that can monitor the behavior of recipients.

4. *Negative income tax.* By the 1960s, the welfare state was firmly entrenched in the industrialized countries. The bureaucracies required to administer poverty programs constituted a major source of expanding government size and power. To aid the poor with minimal government involvement, Milton Friedman proposed a negative income tax.¹⁴ This policy would establish a break-even level of income, and any person earning less than that level would receive money from the Internal Revenue Service (IRS). In effect, the negative income tax would assure that each household received at least a specified minimum income each year. With the IRS handling the negative income tax, the money previously used to administer welfare programs could go directly to people in need. A negative income tax would also maintain the dignity and self-esteem of recipients by allowing them to decide how to spend their benefits and eliminating the shame associated with applying for welfare. Finally, the negative income tax would eliminate differences in levels of aid among states, thereby ending the phenomenon of the “welfare magnet” in which states or cities offering more generous benefits attract additional clients. In the early 1970s, the Nixon administration seriously considered the negative income tax, but it was never adopted. However, today’s U.S. tax code includes an earned income tax credit for low- to moderate-income families that represents a modest step toward the concept of a negative income tax.

5. *Enterprise zones.* Reflecting the belief that government taxes and regulations pose barriers to citizens seeking to escape poverty, Classical Liberals propose the establishment of “enterprise zones” within urban areas, in which lower taxes and fewer regulations would encourage

entrepreneurship and job creation. In contrast to Keynesian policies designed to stimulate job creation through increased spending, enterprise zones are intended to reduce business costs in designated areas and thereby promote economic growth.

THE RADICAL PERSPECTIVE

Explanations of Inequality Although Radicals support differences in wages or salaries for various types of labor, they reject the notion that wealth and poverty are the result of differences in productive contributions of individuals. Instead, they blame highly concentrated ownership of physical and financial capital that creates “market power” and enables corporations to increase profits and suppress wages. Radicals rely on four broad arguments to explain the concentration of wealth that leads to extremes of poverty and inequality.

1. *Past injustices.* The unequal pattern of ownership in capitalism reflects a historical struggle for wealth in which the victors gained power and dominance over the rest of the populace. Past concentrations of wealth in the United States were based not only on the exploitation of workers but also on slavery, theft, and the expropriation of Native American land. In Europe, historical accumulations of land and wealth were accomplished through piracy, plunder, looting, and the “enclosure movement” (i.e., the eviction of many small farmers so that land could be used for grazing sheep to supply wool for the emerging textile industry). Once wealth was sufficiently concentrated, funds became available for the massive investments in factories that would signal the birth of capitalism. The profit from capitalist production arose because most citizens had been stripped of any alternative means of support and had no choice but to engage in factory labor. Faced with plentiful supplies of labor, capitalists gained profit by paying only subsistence wages.

2. *The functionality of poverty and inequality.* According to Radicals, the persistence of poverty and inequality is explained by their functionality or

usefulness in maintaining a capitalist economy.¹⁵ Chronic poverty and unemployment give rise to two conditions. First, unemployed workers provide a buffer to absorb the shocks and dislocations inherent in a dynamic capitalist economy. As firms expand and contract, they can easily change the size of their workforce by hiring or firing part-time or temporary workers while maintaining the loyalty of permanent employees. Second, poverty and unemployment motivate employed workers by creating job insecurity. If there were no unemployment, laborers might become less productive and employers would have to pay higher wages to attract workers from other firms. However, higher wages cause employers to substitute capital for labor, potentially leading to layoffs and unemployment. So, while economic growth may temporarily reduce poverty and unemployment, the depletion of the “reserve army of the unemployed” sets in motion a process leading to renewed poverty and unemployment in the future.

While Classical Liberals claim that technological improvements increase labor productivity and lead to higher wages, Radicals point out that advancing technology can also reduce wages by eliminating some jobs and creating greater competition for remaining employment opportunities. Employers continually seek new supplies of labor to assure that wages will not rise. For example, they may lobby the government to adopt free-trade agreements with other countries, to ease restrictions on immigration, or to reduce welfare benefits so that more individuals will be forced to work. All these policies maintain a surplus of labor, thereby preventing wages from rising and unemployment from falling.

3. *Uneven development.* Both internal and external economies cause economic development to be concentrated in certain regions, thereby contributing to inequality. Internal economies or economies of scale occur when large-scale production results in lower per unit costs. Internal economies allow large firms to drive smaller firms out of business, thus securing market power and high profits for the surviving firms. In contrast, external economies arise when the operation of one firm creates benefits or reduces costs for other firms. External economies explain why economic activity remains clustered in urban areas. For example, much of the

computer industry is located in Silicon Valley in California or along the Route 128 corridor outside of Boston. The presence of local infrastructure, suppliers, and subsidiary industries reduces business costs, attracting additional firms to the area. As a result of uneven development, poverty and inequality may reflect regional patterns of development rather than the abilities and preferences of individuals.

4. *Dual labor markets.* Radicals claim that labor markets in modern capitalist economies are divided into two distinct segments. The primary sector consists of unionized workers and professionals with appropriate credentials and personal attributes who compete for high-paying corporate jobs. The secondary sector is composed of nonunionized workers with less impressive credentials and attributes competing for jobs in smaller firms offering lower wages and less fulfilling work environments.¹⁶ While racial and gender discrimination reinforce dual labor markets, Radicals argue that the fundamental cause of labor market segmentation is the difference in market power between large, oligopolistic firms and small, competitive firms. Large corporations can offer higher wages because they have economies of scale that reduce their per-unit production costs. With lower nonwage costs, corporations can afford to pay higher wages. In addition, with less rigorous competition, oligopolistic corporations can pass on higher wage costs to consumers by raising prices. In contrast, firms in the secondary sector are compelled to repress wages in an effort to gain competitive advantage.

Dual labor markets benefit capitalists by maintaining a stable labor force. High wages and good working conditions for skilled employees in the primary sector secure their loyalty and dedication. Less desirable employees who can be easily replaced remain in the secondary sector. With little mobility between the two labor markets, workers in the primary sector receive wages in excess of the level that would exist in a unified labor market, while workers in the secondary sector earn less. In effect, workers in the secondary sector subsidize the high wages of workers in the primary sector.

Recall that Classical Liberals attribute low wages for menial jobs to the low productivity of workers in those jobs. In contrast, Radicals argue that

workers' productivity is largely shaped by their wage level and work experience. Those who have endured low wages and unpleasant working conditions are likely to exhibit less motivation, more frequent absences, and higher rates of job turnover. In contrast, primary sector workers tend to be highly dependable and committed to their firm because they are paid well and have relative job security. In summary, Radicals claim that attributing low wages to low levels of productivity puts the cart before the horse; low wages and meager job prospects cause low levels of productivity among workers in the secondary sector.

Arguments for Greater Equality Radicals embrace the Enlightenment claim enshrined in the U.S. Declaration of Independence that "all men are created equal." For Radicals, this statement does not mean that individuals have identical abilities, but rather that, by virtue of their citizenship, they possess equal rights to participate in the economic and political processes of the society in which they live. Three arguments underlie the Radical commitment to greater equality.

1. *Justice.* Radicals challenge the Classical Liberal argument that capitalism is fair because each person is rewarded in accordance with the marginal productivity of owned resources.¹⁷ The marginal product of any resource depends on supply and demand that, in turn, are dependent on the pattern of ownership of resources. Therefore, the distribution of income is affected by the pattern of resource ownership. Individuals owning assets in the form of land, capital, or human capital derive income from their assets by making them available for the production of valued commodities. Yet, without a prior justification for the distribution of assets, the marginal productivity theory offers no moral defense of the distribution of income. Even Classical Liberal theorist Robert Nozick acknowledged that coercion and theft have played substantial roles in past accumulations of wealth, rendering today's market-determined distribution of income unfair since it reflects these past injustices.

Radicals argue that concentrations of wealth created by capitalism lead to political and economic power to manipulate both government and markets. As a result, the income going to owners of capital is determined as

much by their power as by the productivity of their capital. The concept of a competitive market in which supply and demand determine prices and incomes is an illusion masking the exercise of power in the market. Radicals support the notion of justice as reward in accordance with productive contribution, but they challenge the Classical Liberal claim that the levels of wages, profits, rent, and interest in contemporary societies accurately reflect the productive contributions of labor, entrepreneurship, land, and capital.

2. *Efficiency.* Whereas Classical Liberals believe that efforts to promote greater equality inevitably reduce economic efficiency by dampening incentives for productive activity, Radicals claim that greater equality would improve efficiency. Poverty prevents individuals from gaining the resources to develop their capabilities and lowers their self-esteem and motivation to excel. At the other end of the social hierarchy, concentrated wealth reduces efficiency as the rich squander their personal abilities in lifestyles of leisure and frivolous consumption. In the workplace, greater equality of rights to participate in decision making would instill dedication and loyalty, resulting in higher productivity. A work environment relying on cooperative, group-oriented relations fosters the sharing of ideas and skills.

3. *Social order.* When poverty and inequality are extensive, a society must devote substantial resources to repress the anger and frustration resulting from deprivation and hopelessness. Police protection, courts and prisons, and elaborate insurance and security measures become necessary. Extreme concentrations of wealth lead to displays of affluence and contemptuous attitudes toward the poor, both of which foster social tension and conflict. Growing inequality also undermines moral restraints on self-aggrandizement. As the standards for financial success escalate, increasing numbers of individuals push the boundaries of ethical behavior in order to distinguish themselves in the race for wealth. This tendency to overstep the boundaries of legal and ethical behavior erodes basic values such as honesty and trust, leading to further social disorder.

To summarize, Radicals object not to differences in income, but to the division of society into an owning class whose income derives primarily from capital, and a working class whose major source of income is wages

for labor. If class differences were diminished, Radicals would accept inequality that reflected the different productive contributions made by individuals. Even Marx supported inequality, arguing that in socialism, justice would be fulfilled when society's tasks and rewards were allocated according to the dictum "from each according to his abilities, to each according to his contribution."

Responses to Poverty

Radicals agree with Classical Liberals that many government efforts aimed at helping the poor actually perpetuate poverty. The social programs associated with the modern welfare state often fail to reduce poverty but simply pacify recipients to maintain social order.¹⁸ The major expansions of the welfare state occurred during the 1930s and the 1960s when widespread discontent threatened to overturn the existing power structure. Radicals conclude that the primary purpose of welfare programs in capitalist societies is to maintain a pool of cheap labor and to control a potentially rebellious lower class. Welfare recipients receive enough income to survive but few incentives or means to escape poverty.

Radicals acknowledge that current levels of welfare benefits may be the most feasible response to poverty at present, but they envision a future in which poverty might be eradicated through a combination of the following policies: 1. *Guaranteed annual income*. During the prosperity of the 1960s, some Radicals proposed that government should guarantee a minimum level of income for every citizen regardless of employment.¹⁹ To the extent that technological advances were displacing labor, Radicals argued that poverty and unemployment could no longer be blamed on individual traits such as laziness or irresponsibility. If the capitalist economy generates and thrives on unemployment, then government should take responsibility for eliminating poverty by assuring every citizen a basic level of income. During both the Nixon and Carter administrations, the U.S. Congress considered proposals to enact a guaranteed annual income, but most Americans resisted the idea of rewarding the "undeserving poor."

2. *Shorter workweek*. One possible solution to unemployment and resulting poverty is to reduce the length of the workweek by several hours.

Assuming that employers would need the same number of total work hours, they would hire more laborers to compensate for the reduced hours of existing employees. France and Germany have experimented with shorter workweeks, but, as is the case with many marginal adjustments, too many other variables affect employment to determine precisely whether reducing hours leads to increased employment. Critics argue that unless productivity increases or wages are cut, a shorter workweek would lead to higher per-unit labor costs and either loss of competitive advantage or the replacement of labor with capital. In either case, employment would presumably decline.

3. *Socialized benefits.* Many Radicals believe that access to basic goods such as health care, education, housing, food, transportation, and old-age financial security should be human rights. The United States and most other developed nations have already taken major steps in this direction with pensions for senior citizens, health insurance for low-income families, public funding of elementary and secondary education, public transportation systems, and school lunch programs. Radicals would like to extend these social benefits to include low-cost higher education, universal health care paid for by the government, and more public transportation such as a national railway system.

4. *Income redistribution.* Although proposals for a guaranteed annual income failed to gain public support, many Radicals continue to favor significant income redistribution from rich to poor through a more progressive income tax, a higher estate tax, a tax on wealth, and higher corporate income taxes.²⁰ With extensive redistribution, many of the government interventions designed to promote greater equality could be eliminated, allowing the market to operate more freely. For example, minimum wage laws, agricultural price supports, unemployment compensation, and welfare programs could all be abolished if poverty and inequality were addressed simply by redistributing the income resulting from market activities. The negative income tax favored by some Classical Liberals and a guaranteed annual income represent two possible forms of income redistribution.

However, Radicals acknowledge the problems posed by redistributing income. First, while the public may support efforts to help children, people with disabilities, and vulnerable citizens, giving money to able-bodied adults is widely unpopular. Second, redistribution dampens the incentives for productive activity. While humans have capacities for generosity, altruism, and empathy, they also calculate costs and benefits of the choices they face. When individuals can be assured of income without working, some will choose not to work. When wealthy investors know that a large portion of their gains will be taxed, they may find other outlets for their resources. In short, major redistribution of income does not seem feasible within the confines of capitalism as it currently exists.

5. *Asset-based redistribution.* In light of the problems confronting income redistribution, Radicals have recently proposed that greater equality should be pursued by redistributing productive assets.²¹ If all citizens owned shares of assets such as workplaces, houses, land, and financial capital, they would be able to earn income by engaging their assets in productive use. Asset-based redistribution would not dampen incentives in the way that income redistribution does, nor would it evoke the same resentment directed toward welfare recipients who receive money without entering the labor force. Ownership of productive assets has the additional benefit of instilling pride and responsibility in individuals, resulting in increased motivation and productivity. Some would use their assets more wisely than others, but the resulting inequality would be substantially less than in present societies where the bulk of assets is owned by a small minority of the population. This proposal reflects a growing disenchantment among Radicals with the traditional vision of socialism as consisting of government ownership of the means of production and central planning of the economy. A more balanced society can be achieved with a market economy in which an equitable pattern of asset ownership has been established and government provides various regulations and insurance programs as buffers against the vagaries of the market.

6. *Economic democracy.* Radicals use the term “economic democracy” to describe their vision of society in which the rights of citizens include the

right to participate in business decision making and to share in the productivity gains accruing to businesses.²² For example, employee stock ownership plans (ESOPs) enable workers to benefit from increased profitability and rising stock prices. ESOPs could be gradually established by requiring that a portion of corporate profits be used to purchase shares of company stock, which would then be distributed to employees. From that point onward, employees would directly benefit from any improvements in the company's profitability.

THE CONSERVATIVE PERSPECTIVE

Explanations of Inequality Conservatives believe that inequality in any society is natural and necessary. They offer the following explanations of inequality: 1. *Innate differences in ability*. Conservatism arose in opposition to the Enlightenment and its defense of the basic equality of all human beings. Conservatives emphasize innate differences in individual abilities, claiming that people naturally gravitate toward those social roles compatible with their strengths and weaknesses. The Italian economist and sociologist Vilfredo Pareto attributed inequality to different psychological characteristics. Some people are forceful and bold, others are clever and innovative, and still others are passive and dull.²³ Pareto concluded that these fixed traits of human nature dictate hierarchical social relations and a relatively constant degree of inequality in every society. Conservatives such as William Shockley (1910–1989), Arthur Jensen (1923–2012), and Richard Herrnstein (1930–1994) have defended inequality on the basis of differences in innate intelligence as measured by IQ tests.²⁴

2. *Capitalism*. During the 19th century, Conservatives criticized the profit-seeking activities of business owners and worried that the dynamism of the market would upset the natural order of society. By mobilizing resources and focusing attention on money-making and consumption, capitalism dislodges citizens from their traditional communities and transforms them into autonomous, calculating maximizers of profit and

utility. Isolated individuals are prone to seek immediate gratification through consumption rather than engage in long-term, constructive efforts to build meaningful lives through education, marriage, family life, work, and involvement in their communities. Conservatives conclude that by encouraging the pursuit of immediate gratification, capitalism contributes to poverty and misery.

During the early stages of capitalism, Conservatives frequently clashed with Classical Liberals by advocating political controls to curb the excesses of capitalism. Although Conservatives now accept capitalism, they continue to worry that unregulated markets will disrupt the natural hierarchy and jeopardize stability and social order. Of particular concern is free trade between countries. Some Conservatives claim that competition with low-wage countries is causing conflict and strife in the developed nations by pulling down wages and destroying industries.²⁵

3. *Government.* During the 19th century, Conservatives expected political leaders to place restraints on competition in order to preserve traditional social institutions. They held government responsible for fostering a social and cultural environment supportive of individual virtue and self-restraint. However, as larger portions of the population gained the right to vote, Conservatives feared that politicians would pander to voters with promises of social benefits and redistribution of income. They also joined with Classical Liberals in viewing government as vulnerable to “rent-seeking” by powerful interest groups. After witnessing the Russian Revolution, fascism in Europe, and the New Deal in the United States, Conservatives concluded that government, rather than capitalism, represents the greater danger to society. Government subverts the natural order when it is controlled either by demagogues claiming to represent the masses or by special interest groups.

4. *Cultural differences.* Conservatives view culture as a key determinant of individual behavior and argue that some cultures generate more poverty and inequality than others.²⁶ Cultures that place high value on traits such as punctuality, a strong work ethic, delayed gratification, individual

responsibility, and trust tend to prosper, while other cultures in which these virtues are less evident lag behind.

5. *Functionality of hierarchy*. The sociologist Talcott Parsons (1902–1979) sought to understand social institutions by analyzing their function in promoting stability and prosperity. Two of Parsons’s students, Kingsley Davis (1908–1997) and Wilbert Moore (1914–1987), suggested that inequality of wealth, power, and status is “functional” in achieving society’s goals of increased production and social order.²⁷ Davis and Moore claimed that without clear lines of authority embedded in hierarchical social relations, individuals become isolated and confused about their roles in society. A breakdown occurs in the socialization process by which individuals learn and adopt values, goals, and patterns of behavior conducive to social order.

Hierarchy in the workplace is necessary for effective coordination of production. Hierarchy minimizes conflict by establishing rights and duties attached to particular social roles, thereby enabling individuals to form reasonable expectations about the behavior of others. The unequal rewards for different positions in the social hierarchy remain essential to recruit talented persons to fill the most important and difficult roles. Without substantial differences in financial remuneration and social status, few people would aspire to positions requiring substantial time and effort to gain the required skills and knowledge.

Since hierarchy and inequality are functional in achieving society’s goals, they will arise even if personal abilities are quite similar. Even if a particular society lacks highly talented citizens, some individuals will, perhaps arbitrarily, be designated as leaders and authority figures. In such circumstances, a high income does not necessarily reflect the personal attributes of the recipient but rather attests to society’s need to legitimize leadership roles by attaching money and status to them.

Arguments for Inequality Conservatives justify inequality with the following arguments: 1. *Political stability*. Several prominent Conservatives have attributed the rise of totalitarianism (e.g., communism and fascism) to the effects of capitalist industrialization in

destroying traditional patterns of hierarchy and inequality during the 19th century.²⁸ As the power and wealth of landowners and aristocrats were challenged by the rising class of capitalists, the medieval social order no longer seemed natural or inevitable. Without the restraints of traditional sources of authority, citizens became increasingly dissatisfied with their social status and envious of their superiors. The egalitarian spirit unleashed by the French Revolution created a flood of rising expectations as citizens began to pursue their self-interests aggressively. The spread of democracy meant that government could no longer play its proper role of promoting the public interest by serving as a neutral arbiter of conflicting private interests. Instead, the political process became little more than an extension of the struggles for dominance within the private sector. In the first half of the 20th century, as conflict engulfed countries such as Russia, Germany, and Italy, they turned to totalitarianism in order to restore the authority of government over all private interests. Conservatives believe that if hierarchical authority and traditional communities had been protected against the disintegrating effects of capitalism and modernization, communism and fascism might never have arisen.

2. *Social stability.* According to Conservatives, the inequality associated with a natural order arouses little conflict, resentment, or animosity. Individuals know their place in the hierarchy and take pride in performing their roles well. They find meaning and purpose within “intermediate institutions” such as the family, religious groups, and their communities. From the Conservative perspective, these institutions function best when hierarchical authority is present. The father should be the leader of the family, just as ministers, priests, imams, or rabbis lead churches. Communities need leaders either elected or who simply emerge based on their charisma and abilities. Leaders must not only exercise their superior skills and knowledge but also serve as visible role models for other citizens. Natural leaders in government, business, churches, communities, and families set standards of conduct and ethics for their followers.

Conservatives argue that efforts to reduce inequality through government welfare programs and other social benefits tend to displace and weaken

intermediate institutions. For example, welfare programs undermine the nuclear family as governments replace fathers in supporting the family. Neighbors rely less on each other as government provides services such as health care and old-age security. Without hierarchy and inequality, the institutions holding society together begin to crumble as individuals focus on the pursuit of self-interest.

3. *Economic growth.* Conservatives share with Classical Liberals the belief that hierarchy in the workplace and the resulting inequality among employees are essential for efficiency and growth. To be fully productive, workers must accept the authority of managers and owners to make appropriate business decisions. Moreover, unequal incomes and concentrations of wealth provide the savings to fund investments in expanding productive capacity.

4. *Preservation of culture.* Concentrations of wealth are necessary to generate funding for cultural institutions such as museums, opera companies, and symphony orchestras. Inequality of wealth and social status sustains a variety of talents and cultures. Attempts to reduce inequality create a “mass society” with a homogenized culture in which individuals have difficulty developing unique personal identities.

Responses to Poverty

Conservatives tend to downplay the severity of poverty in the industrialized nations, pointing out that many citizens receiving welfare benefits own cell phones, computers, and cars and live quite comfortably compared to the truly impoverished persons in developing nations.²⁹ However, recognizing that even the perception of injustice creates conflict in society, Conservatives propose the following policies to reduce poverty:

1. *Community revitalization.* Communities are more than just residential groupings such as towns or villages. Any group of people having shared interests may form a community. Conservatives value strong, vital communities for providing individuals with social networks within which to develop their identities and find meaning in their lives.³⁰ However, as capitalist industrialization breeds increasing individualism, materialism, and

secularism, only those communities seeking to promote narrow economic self-interest (e.g., professional organization, trade associations, and lobbying groups) continue to thrive. Communities such as extended families, churches, and civic organizations that nurture human development and care for the disadvantaged have been steadily undermined by the forces of modernization. Conservatives propose two possible strategies for revitalizing communities. The first involves a renewal of religion similar to the “Great Awakenings” that occurred in the United States during the mid-19th century. The rise of evangelical Christianity gives Conservatives hope that the United States may regain its moral compass. A second approach to rebuilding communities involves the establishment of appropriate government policies to combat the disintegration of communities and the resulting isolation and impoverishment of some individuals.³¹ For example, families could be strengthened by changing the tax code to provide larger deductions for married couples and for children. The role of churches could be expanded by giving them responsibility for administering welfare programs. If national and state governments delegated many of their functions to municipal governments, local communities would gain greater autonomy and self-determination. With the restoration of healthy communities, many individuals unable to support themselves due to disabilities would be cared for by families, neighbors, or churches.

2. *Welfare reforms.* The first welfare state in the world was established in Germany in the late 19th century. The Conservative German chancellor Otto von Bismarck (1815–1898) realized that industrialization fostered conflict among workers, capitalists, and the land-owning aristocracy. To preserve national unity and maintain social order, Bismarck instituted national health insurance, disability insurance, and old-age pensions. Conservatives today somewhat reluctantly accept welfare programs designed to lift recipients out of poverty, but they criticize current welfare policy for being overly generous and perpetuating poverty by creating dependency on government support. Conservatives accuse liberal politicians of using welfare benefits to attract the votes of low-income citizens. From this perspective, the welfare state has expanded as liberals seek to win elections by making more voters dependent on the government

for financial support.³² Conservative proposals for welfare reform include time limits on eligibility for welfare, requirements for training and education, and stipulations encouraging marriage and family unity.³³

3. *Tracking*. Conservatives believe that poverty in affluent societies is more a matter of perception than actual material deprivation. However, they remain concerned about poverty, fearing that perceptions of injustice fuel crime and class hostility by breeding resentment and envy among the poor. One way to reduce the threat posed by poverty is to lower the expectations of the poor. Conservatives argue that equal education for all students creates unrealistic expectations of success among students with lower abilities. When these students complete their formal education and discover that their earning capability is minimal, they react with anger and frustration. To address this problem, Conservatives propose a more rigorous system of tracking in public schools to steer students toward courses and careers suitable to their abilities.

4. *Eugenics*. If, as many Conservatives believe, differences in individual abilities are genetically predetermined, then the overall quality of the human race could be improved by selective forms of population control such as euthanasia or sterilization of those with inferior genes. During the late 19th century, an ideology called Social Darwinism arose, claiming that Darwin's evolutionary principle of "survival of the fittest" applied to contemporary society. Social Darwinists attributed poverty to inferior genes and concluded that poverty could be reduced by preventing the poor from reproducing and passing their genes on to future generations. Such thinking was common among Conservatives during the early 20th century as evidenced by the rise of an active "eugenics" movement. Prisoners and patients in asylums for the mentally ill were sometimes subjected to forced sterilization. The practice of eugenics reached its peak during the Nazi era in Germany when the government engaged in a concerted effort to breed a "super-race" by choosing which adults could reproduce and by engaging in genocide to eliminate millions of citizens deemed to be genetically deficient. After WWII, eugenics was tainted by its association with Nazism, but some Conservatives continue to search for morally acceptable ways to

control human reproduction. For example, the Nobel laureate physicist William Shockley (1910–1989) established a sperm bank whose donors were limited to other Nobel Prize winners.

THE MODERN LIBERAL PERSPECTIVE

Explanations of Inequality Modern Liberals agree with Classical Liberals that a significant portion of social and economic inequality results from differences in individual abilities and preferences. However, Modern Liberals view these differences as largely shaped by the social environment in which individuals develop. They believe inequality could be dramatically reduced by promoting equal opportunity for all citizens to advance in society. Unlike Classical Liberals, Modern Liberals claim that equal opportunity requires substantially greater equality of material conditions, including access to basic necessities such as education, health care, and food. Modern Liberals attribute inequality to the following factors: 1. *Cycle of poverty*. Inequality and poverty tend to be self-perpetuating. Children who grow up in poor families typically receive less attention from their parents, live in blighted neighborhoods, and attend inferior schools. With limited opportunities and lack of money, they tend to devalue education, avoid marriage, fail to develop self-esteem and social skills, and focus on immediate gratification rather than long-term goals. Whereas Classical Liberals regard these traits as innate individual preferences, Modern Liberals view them as pragmatic responses to the often hopeless situation in which some individuals find themselves.

2. *Market power*. Modern Liberals argue that differences in individual abilities and preferences explain only part of inequality. In addition, differences in power shape the distribution of income, and power in the market derives from restricted competition. As economies of scale result in the dominance of major industries by a few large corporations, these companies gain the power to raise prices and increase profits. The Classical

Liberal claim that factors of production are rewarded in accordance with marginal productivity is invalidated by the prevalence of market power throughout the economy. The English economist Joan Robinson (1903–1983) demonstrated that when competition is imperfect, workers will be paid less than the value of their marginal product.³⁴

3. *Discrimination*. The market permits the expression of all preferences backed by money, including bigotry. When prejudice is combined with market power, discrimination can flourish. Those individuals whose race, gender, ethnic background, age, appearance, or sexual orientation does not match established social norms may encounter difficulty in achieving economic success.

4. *Unequal education*. Modern Liberals believe that public education is underfunded and that local financing of schools results in unequal education for children from different social classes. Without equal education, individuals cannot have equal opportunity for success.

5. *Technology*. Modern Liberals agree with Classical Liberals that advancements in technology contribute to greater inequality. Firms typically adopt more capital-intensive technology to reduce costs by replacing workers with machines. The substitution of capital for labor raises the productivity of workers who remain employed while potentially causing layoffs and unemployment. Technological developments in communications and data processing have created economies of scale and fueled waves of corporate mergers and acquisitions. Mergers typically result in significant layoffs of employees made redundant by combining operations. More generally, sophisticated technology has increased the demand for workers with specialized knowledge and reduced the demand for workers with common skills and knowledge. For example, the development of computer technology displaced thousands of bookkeepers while Bill Gates became one of the wealthiest individuals in the world.

6. *Globalization*. As national economies are increasingly integrated into a unified global market, inequality has risen in nearly every country.

Workers throughout the world now compete against one another for jobs, thereby placing downward pressure on wages. Although immigration laws restrict the mobility of labor, corporations can move jobs abroad in search of lower labor costs. Corporate outsourcing of jobs has decimated the manufacturing sectors of developed nations. Globalization has also contributed to wage stagnation by undermining the bargaining power of labor unions. Since capital is much more mobile than labor, owners of capital have gained increased power in negotiations over wages. When faced with the prospect of outsourcing, unions and workers have little choice but to accept corporate wage offers.

7. *Government policies.* From the Great Depression of the 1930s until the mid-1970s, governments launched concerted efforts to reduce inequality through policies such as welfare programs, farm price supports, and minimum wage laws. However, beginning with the Reagan administration in 1981, government policy shifted toward policies that led to greater inequality based on the Classical Liberal belief that inequality is essential for efficiency and growth.³⁵ Examples of government policies contributing to inequality include reducing the progressivity of the income tax, lax enforcement of antitrust laws, weakening labor unions, deregulation, free trade agreements, and cuts in welfare programs.

Arguments for Greater Equality Modern Liberals believe that substantially greater equality can be achieved within a capitalist economic system. In fact, they argue that poverty and inequality harm not only the poor but also the economy and society as a whole.³⁶ Modern Liberals rely on the following arguments to support policies aimed at reducing poverty and inequality: 1. *Maximization of utility.* The utilitarian philosophy developed by Jeremy Bentham and John Stuart Mill provided the first Modern Liberal argument for greater equality. If individuals possess equal capacities for pleasure, then the law of diminishing marginal utility suggests that a rich person derives less satisfaction from an additional dollar of income than does a poor person. Therefore, redistributing income from rich to poor would increase total

satisfaction because the loss of utility by the rich would be less than the gain in utility experienced by the poor.

2. *Social mobility*. Modern Liberals believe that social mobility (i.e., the ability of individuals to climb the socioeconomic ladder and achieve success commensurate with their abilities) is essential to maintaining the justice and legitimacy of a capitalist economy. Yet, without substantial equality of social backgrounds, individuals cannot have equal opportunity to pursue their ambitions. Modern Liberals point to data showing that social mobility has decreased as inequality has increased during the past three decades. The United States has relatively high inequality and relatively low levels of social mobility compared to other industrialized nations.³⁷

3. *Political stability*. Extreme inequality breeds frustration, anger, and resentment among less successful individuals. They increasingly come to regard the high incomes of the affluent not as rewards for productive work but as loot gained through the exercise of power in manipulating the market. The market and the government lose much of their legitimacy as they are perceived as functioning to benefit powerful interest groups. Growing inequality also causes the wealthy to opt out of public services and insulate themselves within “gated communities” where they are protected from the social ills associated with inequality. As class lines become more rigid, political extremism undermines a nation’s ability to govern through consensus. Modern Liberals claim that both fascism and communism were fueled by widespread frustration as citizens lost faith in the ability of both capitalism and democratic governments to prevent poverty, unemployment, and excessive inequality. In contemporary U.S. politics, growing inequality has disrupted the status quo as both the Tea Party on the right and Occupy Wall Street on the left were based on the belief that the economy is rigged in favor of wealthy elites.

4. *Freedom*. The English philosopher Thomas Hill Green (1836–1882) argued that freedom requires access to basic necessities such as food, clothing, shelter, education, and health care. Government can promote freedom by establishing “human rights” or “citizenship rights,” including

not only civil rights such as freedom of speech but also economic rights to employment, a basic standard of living, and other requisites of a dignified life. Since the market recognizes only property rights, government should supplement the market by protecting human rights. For example, if citizens have a right to work, government could become the “employer of last resort” by hiring any citizen unable to find employment in the private sector.

5. *Economic stability and growth.* The English economist John Maynard Keynes (1883–1946) added another powerful argument for pursuing greater equality. Wealthy households spend a smaller fraction of their income than do poor ones. As inequality increases, a larger share of national income goes to households more likely to save, resulting in insufficient consumer spending to sustain a healthy economy. A redistribution of income from rich to poor could theoretically increase total spending, thereby creating more jobs and increased output. The appeal of the Keynesian argument is that everyone benefits from greater equality. Even the rich, despite paying higher taxes to finance redistribution, benefit from a growing economy.

Inequality also jeopardizes economic stability by creating more savings than can be profitably invested in expanding productive capacity. Instead, the money is used for speculating in land, housing, collectibles, and the stock market. This speculation leads to “asset bubbles” as assets become overpriced. Inevitably, the bubbles burst, and the economy plunges into recession.

To challenge the Classical Liberal assertion that substantial inequality is a prerequisite for economic growth, Modern Liberals note that international comparisons reveal little correlation between inequality and growth. Countries such as Japan and Germany have more equal distributions of wealth and income than does the United States and yet have experienced extended periods of rapid growth. With less poverty, these countries are able to use public funds for investments in infrastructure such as highways, schools, and scientific research instead of crime control and welfare programs.

6. *Maximization of social welfare.* Economists use the term “welfare” as a synonym for “well-being.” Welfare economics is the branch of economics

studying the conditions under which society's well-being would be maximized. Whereas earlier economists such as Stanley Jevons (1835–1882) assumed that free markets create maximum welfare, the discovery of market failures such as externalities and public goods provided strong arguments for government intervention. By the 1930s, economists such as Abram Bergson (1914–2003), John Hicks (1904–1989), Nicholas Kaldor (1908–1986), and Abba Lerner (1903–1982) had uncovered a more serious problem with markets. They demonstrated that even a perfectly competitive market with no market failures cannot be expected to produce maximum social welfare. While the market may be efficient, efficiency means only that individuals gain maximum utility from the “initial endowments” of assets with which they enter into market exchanges. However, a different distribution of these assets might result in greater social welfare. Welfare economists reached the dramatic conclusion that markets will maximize social welfare only if an optimal distribution of assets has first been established. Welfare economists do not claim to know this optimal distribution of assets, but they look to the political process to establish it. Welfare economics represents the logical culmination of utilitarianism. If society's goal is to maximize utility or welfare, then only those property rights contributing to that goal can be defended. Although Modern Liberals do not specify which property rights are legitimate, they often presume that redistribution in favor of the poor would improve society's well-being.

7. *Efficiency.* Economic efficiency requires that all mutually beneficial transactions occur. Suppose that a wealthy person wished to give money to a poor individual in order to experience the satisfaction associated with generosity or to alleviate crime and other social ills that arise from poverty. While such a donation could be made person-to-person or through a private charity, many potential donors will refrain because they know that their individual contribution will have no significant impact on poverty. This problem arises because the distribution of income is a “public good” and is subject to the “free rider problem.” Many citizens might desire a more equal distribution of income, but instead of contributing to charity, they remain “free-riders,” hoping to benefit from someone else's efforts to reduce poverty. Economists Harold Hochman and James Rodgers demonstrated that because the distribution of income is a public good, the market will fail

to create an efficient allocation of resources.³⁸ In this case, government efforts to redistribute income can be justified purely on the grounds of improved efficiency since the poor can be made better off without necessarily hurting the rich who would benefit from having less poverty, crime, and suffering in society.

8. *Justice*. Modern Liberals challenge the justice of market-determined distributions of income on three grounds. First, because markets are never perfectly competitive, the distribution of income is affected by the relative power of different groups as well as the productivity of their economic resources. Second, the distribution of income is only as fair as the pattern of ownership of productive assets, and that pattern reflects all the historical injustices by which individuals have enriched themselves through unethical means such as theft, fraud, and slavery. Third, the market distributes income based only on property rights, while justice requires the additional protection of human rights such as nondiscrimination and occupational health and safety. For these reasons, Modern Liberals claim that greater equality is necessary to achieve justice.

With the exception of philosopher John Rawls (1921–2002), Modern Liberals have been reluctant to specify an optimal distribution of income. In fact, many Modern Liberals remain skeptical and cautious about redistribution. Bentham and Mill opposed significant redistribution on the grounds that property owners would feel threatened and would cease to engage their assets in productive ventures. Modern Liberal economists have also expressed concern that, beyond a certain level, equality remains incompatible with economic efficiency.³⁹ Efforts to promote equality may dampen the incentives for work and investment by both those from whom money is taken and those to whom money is given. With reduced incentives, the level of economic activity may decline. This “big trade-off” between equality and efficiency is the primary reason for Modern Liberals’ caution about major efforts to redistribute income.

Responses to Poverty

Modern Liberalism currently stands at an historic watershed in its approach to poverty. In the past, Modern Liberals condemned the market

for permitting and even exacerbating poverty and favored government programs to achieve a more balanced distribution of income. They relied on policies such as the progressive income tax, the inheritance tax, welfare programs, labor unions, agricultural price supports, rent controls, minimum wage laws, and social security to reduce poverty and inequality. While Modern Liberals acknowledged that regulated prices such as farm price supports and minimum wages might cause inefficiency, they viewed such policies as more politically feasible than outright redistribution of income. For example, voters are more likely to favor price supports for milk rather than direct cash transfers to dairy farmers.

Despite billions of dollars spent on reducing poverty, including Lyndon Johnson's War on Poverty during the 1960s, Modern Liberals have had to confront the stubborn persistence of poverty. Whereas Classical Liberals and Conservatives are more likely to accept poverty as the inevitable fate of individuals who lack abilities or make bad choices, Modern Liberals remain determined to diminish poverty. However, their efforts face two major constraints. First, the enormous size of the national debt, some of it due to massive spending on poverty reduction in the past, precludes significant increases in government spending without corresponding tax hikes. Second, the failure of past efforts to reduce poverty has led to declining public support for welfare programs. Modern Liberals now risk losing elections if they propose additional spending to aid the poor. Recognizing the unpopularity of traditional welfare programs, Modern Liberals now urge that public policy be oriented less toward direct aid to the poor and more toward changing incentives so as to bring previously marginalized groups into the labor force.⁴⁰ To accomplish this goal of "inclusion," Modern Liberals propose the following: 1. *Welfare reforms*. During the Clinton administration, Modern Liberals made significant concessions by tightening the eligibility requirements for welfare. If welfare benefits are more difficult to obtain, presumably some individuals will make the effort to become more employable and to support themselves. In the past, Modern Liberals would have rejected cuts in welfare as mean-spirited and cruel, but they now accept elements of the Classical Liberal argument that reductions in welfare can liberate the poor from lives of idleness and dependency.

However, Modern Liberals would maintain benefits for people unable to support themselves due to physical or mental disabilities.

2. *Manpower policy*. If welfare benefits are reduced, former recipients need employment opportunities. Modern Liberals offer several proposals to increase employment of previously disadvantaged groups. Affirmative action programs encourage employers to search for qualified minority and female candidates to fill job openings. Government assistance with the expenses of job searches and relocation would open a wider range of job opportunities for unemployed workers. Government could offer subsidies to employers who hire and train previous welfare recipients. Finally, government could become the “employer of last resort” by hiring unemployed workers to engage in public works projects such as repairing highways, bridges, and damage from natural disasters.

3. *Livable wage*. Given the declining real value of the current minimum wage, Modern Liberals propose requiring employers to pay a higher “livable wage” sufficient to keep individuals out of poverty. In response to Classical Liberal claims that raising the minimum wage would cause more unemployment, Modern Liberals cite a study by economists David Card and Alan Krueger that found no correlation between a higher minimum wage and job loss.⁴¹ Raising the minimum wage need not increase unemployment if labor productivity rises due to increased job satisfaction and lower turnover rates among workers. Higher wages also provide incentives for employers to improve labor productivity by upgrading the skills of their workforce.

4. *Tax reforms*. Modern Liberals propose to make the income tax more progressive by reducing the burden on low-income households and raising tax rates on more affluent households. This goal could be accomplished by changing marginal tax rates for different income categories, by enlarging the earned income tax credit, and by closing loopholes and deductions that benefit primarily wealthy households. Modern Liberals dispute the Classical Liberal claim that raising taxes on the rich will discourage their productive activity, making the argument that higher taxes might elicit

greater efforts as high-income households need to earn more to maintain the same after-tax income.

5. *Education policy.* Since Modern Liberals point to differing educational opportunities as one of the causes of poverty and inequality, they focus on educational reforms as a significant part of the solution. Financing public education through federal tax dollars instead of local property taxes would assure more equitable physical facilities and teacher salaries. Increased funding for early childhood development and day care programs would narrow the gap in children's preparation prior to entering school. Free tuition to community colleges and vocational schools would allow children of low-income families to gain employable skills.

6. *Fair trade.* To combat the effects of globalization in suppressing wages in developed nations, Modern Liberals propose fair trade instead of free trade. Fair trade would require that all countries adhere to similar regulations, including environmental standards and protection of workers' rights, so that no nation is able to gain competitive advantage by reducing costs through pollution or exploitation of workers.

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Chapter 10

Labor and Industry

Work occupies a central role in the lives of most people, and the organization of work affects nearly all dimensions of human existence. Political economists have long debated the question of how best to coordinate society's productive activities. How should labor be divided, firms and industries organized, and authority delegated? Is the market alone capable of yielding the optimal organization of work or does government play a necessary role in assuring that work is both efficient and satisfying to the people involved? In this chapter, we investigate sharply contrasting interpretations of the role of work in human life, the structure of authority in production, and the effect of labor unions on the economy.

THE CLASSICAL LIBERAL PERSPECTIVE

The Nature of Work

The early development of Classical Liberalism coincided with the rise of the factory system and large-scale production in the 18th and early 19th centuries. Formerly independent farmers and craftsmen were transformed into wage laborers dependent on employers for their livelihoods. Because

factory work was often dangerous and stultifying, Classical Liberals assumed that work was unpleasant and would be performed only as a means to survival. Adam Smith worried that monotonous industrial jobs would cause workers to become “as stupid and ignorant as it is possible for a human creature to become.”¹ To motivate workers to accept factory jobs, Classical Liberals attempted to abolish all forms of public welfare such as poor houses and to increase the penalties for vagrancy and theft.

Classical Liberals no longer believe that work is inherently harmful, but they do assume that most individuals would prefer not to work. Only the “stick” of hunger and the “carrot” of monetary rewards motivate the decision to work. Individuals work because the anticipated utility from spending their earnings exceeds the costs in terms of sacrificed leisure and the hardship of labor. Individuals decide when, where, and how much to work by assessing the relative benefits and sacrifices associated with different employment opportunities and then choosing the type of work offering the greatest net benefit.

Although some talented individuals will be able to support themselves through personally fulfilling work, Classical Liberals assume that most people view work as a “disutility.” Employment is merely a means to earn money to meet basic needs and to enjoy leisure time more fully. Unstimulating work may actually appeal to those seeking to support themselves with the least possible mental and physical effort. If others desire more fulfilling work, Classical Liberals defend the market as the best guarantee that such preferences can be met. For example, artists may devote themselves to their creations if they are willing to accept a lower standard of living. Those who value a more personalized work environment may seek employment in small businesses and thereby sacrifice the higher wages and greater job security typically offered by large corporations. The market allows each individual to balance the desire for satisfying work against the value of higher wages.

The Organization of Work

Classical Liberals claim that market competition compels firms to adopt the most efficient division of labor and structures of authority. Any employer adopting a less efficient organization of work would experience

higher costs of production, reduced profits, and eventual bankruptcy. As a result, the history of capitalism consists of a continual improvement of efficiency as increasingly superior institutions arise over time.

As mass production expanded in the early 20th century, management experts such as Frederick Taylor (1856–1915) and Frank Gilbreth (1868–1924) initiated “time-and-motion studies” to reduce skilled jobs to routine motions, which any worker could quickly master.² Taylor’s “scientific management” rested on the Classical Liberal view of work as intrinsically unpleasant. He assumed that workers derive little satisfaction from their jobs and, therefore, would not object to more routinized work. Scientific management would actually relieve workers from all responsibilities for planning and coordinating the production process as they simply engaged in repetitive physical motions. This organization of labor would also permit management to monitor work performance more effectively by establishing time and output standards for each specific task.

In arguing that the market dictates the most efficient organization of work within each firm, Classical Liberals encounter a dilemma. On one hand, they defend individual choice coordinated by the market as the best institutional arrangement for promoting efficiency, but they simultaneously argue that efficiency within the firm requires hierarchical, centralized authority, leaving workers with no choice other than keeping their jobs or relinquishing them. The success of the modern corporation would seem to indicate that efficiency can be enhanced by suppressing individual choice over a significant range of the production process. Each firm represents a miniature “command economy” within an otherwise free market.

To resolve this apparent contradiction, Classical Liberal economists have formulated “new institutional economics” to demonstrate that corporate hierarchies and other seemingly nonmarket institutions are efficient and arise from the rational choices of self-interested individuals.³ New institutional economics begins with the assumption that individuals pursue all mutually beneficial economic transactions because both buyer and seller stand to gain. However, some of the benefits of a transaction may not be realized immediately, so a contract is required to specify the future rights and obligations of each party. Yet contracting is often made difficult by the presence of “transaction costs.” These costs are not directly related to the

production of a commodity and include the cost of gathering information prior to a transaction, negotiating the terms of trade, and specifying and enforcing any contracts.

In the case of labor contracts, employers typically do not fully specify the obligations of both labor and management in a contract. Their reluctance stems from limited knowledge about the potential productivity of workers as well as a desire for flexibility in assigning tasks. According to Classical Liberals, a hierarchical structure of authority within the firm solves these difficulties in labor contracting by establishing a pyramid of command through which employers may assign tasks and monitor work performance. Hierarchy permits firms to reduce transaction costs that would arise from drawing up a fully specified contract for each worker. The firm will expand hierarchical control as long as the benefits gained by reducing transaction costs and increasing output exceed the cost of hiring additional supervisory personnel. Employees opt to work under hierarchical command because the increased efficiency enables firms to pay higher wages. Classical Liberals conclude that no contradiction exists between the virtues of free markets and the suppression of choice and market forces within the firm.

Classical Liberals offer an explanation for differences in the management of white-collar versus blue-collar workers. Because employers assume that manual labor is unpleasant and unfulfilling, they conclude that blue-collar workers will shirk their duties unless faced with the prospect of detection and penalties such as being demoted or fired. Therefore, rigid hierarchies and overt authority prevail in industries such as mining and manufacturing. White-collar workers, in contrast, are more likely to resent close supervision and their work is more difficult for management to monitor. White-collar workers often acquire skills on the job, so management relies less on the threat of dismissal since training replacements is costly. In these circumstances, direct supervision may be less efficient than instilling in workers a sense of dedication and loyalty to the firm. Owners accomplish this goal by paying good salaries and establishing promotion ladders and pay raises based on seniority as well as job performance. Paying higher salaries becomes economical from the employers' viewpoint if productivity is increased by promoting loyalty and reducing job turnover.

For Classical Liberals, the prevalence of hierarchically organized firms proves their efficiency. If more egalitarian structures of authority were efficient, then at least one business owner would experiment with greater worker participation in decision making and potentially drive hierarchical firms out of business. Classical Liberals offer an explanation for the efficiency of hierarchy. If firms were managed by workers, then the benefits of productivity gains would presumably be distributed among all workers. However, the amount received by any individual would be too small to provide an incentive to engage in managerial tasks such as revamping the production process and monitoring the effort of fellow workers. Only when the benefits of enhanced productivity accrue to a small number of owners and supervisory personnel will the financial incentives for each individual be adequate to motivate effective management of the firm.

Classical Liberals defend hierarchy within the firm as being entirely consistent with workers' freedom. If hierarchy increases the efficiency essential to the long-term viability of the firm, then even firms owned by the employees would appoint or hire supervisory personnel and provide incentives for effective supervision by granting managers a significant portion of the benefits accruing from increased productivity. Classical Liberals conclude that the organization of work and the structure of authority are independent of firm ownership. In the words of Paul Samuelson (1915–2009), “it makes no difference whether capital hires labor or the other way around.”⁴

Workers may seek employment in less hierarchical firms if they so desire. However, the fact that most workers choose jobs with hierarchical firms suggests that they value high wages more than an egalitarian work environment. Workers who seek a more participatory, egalitarian firm can agree to work for lower wages to offset the loss of efficiency. In theory, employers would willingly dismantle hierarchy in exchange for lower wages as long as the reduced wage costs offset any loss of productivity. If employers resist change, groups of workers could solicit loans to start their own firms, and if egalitarian organizations of work proved to be more efficient, these worker-owned firms would gradually drive hierarchical firms out of business. However, the virtual absence of large worker-

controlled firms in capitalist societies persuades Classical Liberals that hierarchy remains the most efficient form of work organization.⁵

The Role of Unions

Classical Liberals oppose labor unions, viewing them as groups seeking to promote their self-interest at the expense of the rest of society. Union efforts to raise wages above the market-determined level lead to a variety of problems:

- Higher wages cause employers to substitute capital for labor and, therefore, destroy jobs.
- Employers who operate in competitive markets will have difficulty in raising prices and so their profits may decline. With lower profits, firms may expand more slowly, relocate, or shut down.
- Employers with sufficient market power to pass on increased wage costs in the form of higher prices will be able to avoid falling profits, but consumers will bear the burden of a rising cost of living.
- When consumers pay higher prices for goods produced by unionized labor, the demand for other goods falls and firms in those industries must either cut wages or reduce production and lay off workers. Therefore, the gains made by unionized workers come largely at the expense of other workers.
- Inflation caused by higher union wages may cause the government to implement contractionary fiscal and monetary policies that slow the economy and cause unemployment.

In addition to raising wages, unions also reduce productivity. For example, unions may oppose technological innovations that threaten jobs. Job security, pay scales, and promotions based on seniority reduce the incentives for high performance. Unions also practice “featherbedding” by retaining jobs rendered obsolete by changing technology. By emphasizing the conflicting interests of management and workers, unions breed animosity and resentment in the workplace. Classical Liberals insist that both management and workers share a common interest in high profits so that firms can expand, create new jobs, and pay higher wages in the future.

Historically, mass unionization did not succeed until unions were exempted from antitrust laws and protected by favorable legislation such as the Norris–La Guardia Act of 1932. To weaken unions, some Classical Liberals propose the application of antitrust laws to unions, legal limitations on the right to strike, and “right to work” laws abolishing mandatory union membership in certain industries or firms.

THE RADICAL PERSPECTIVE

The Nature of Work

Radicals believe that work should be an essential component of human existence. The active engagement of one’s physical and mental capacities in purposeful activity designed to create useful products is intrinsically fulfilling. Work provides a context for human development through the exercise of one’s talents and abilities, the formation of meaningful social relations, and the transformation of ideas into material form. The products of work are expressions of ourselves; we come to know ourselves through the fruits of our labor.

However, Radicals depict most work in capitalist societies as degrading and alienating.⁶ To maximize profit, employers divide work into repetitive motions requiring little skill, thought, or creativity. In addition, managers monitor the work process, suppressing workers’ sense of autonomy and dignity. Since capitalists own the products of labor, workers are denied the pride and gratification that comes from viewing their products as extensions of themselves. As a result, most jobs in a capitalist economy offer little personal satisfaction to workers.

Radicals condemn capitalism for separating labor from the means of production. A small group of people—the capitalists—own the factories and businesses, control the organization of work, and, at the end of the production process, own the products of labor. Because labor in a capitalist system remains oppressive, it robs workers of essential aspects of human existence. Even in their leisure time, alienated workers focus their lives around biological functions such as eating and drinking rather than developing their uniquely human capacities for creativity and expression.⁷

Dissatisfaction with work spills over into personal life, contributing to problems such as divorce, substance abuse, family violence, and mindless consumerism. Radicals view these behaviors as conditioned by capitalism rather than intrinsic to human nature. Workers who endure boring jobs will inevitably be frustrated with the diminished quality of their lives.

If work in capitalism is so oppressive, why is there so little active resistance to capitalist control of production? Radicals explain that most individuals have no access to alternative means of productions and, therefore, stand at the mercy of employers. Moreover, workers experience what Radicals call “false consciousness.” Because capitalists treat laborers as factors of production rather than as human beings, workers develop correspondingly low self-esteem and accept their fate. Workers may exhibit what psychologists call a “hostage syndrome.” Hostages may come to identify with and develop sympathy for their captors who exert complete power over them. Workers, who are essentially captive to the power of capitalists, may cease to resist their plight and actually seek approval from their employers as a means of self-validation.

Radicals have not formed a consensus on the potential nature of work in a postcapitalist society. Marx envisioned a future society without hierarchy or a division of labor in which a person could “hunt in the morning, fish in the afternoon, rear cattle in the evening, [and] criticize after dinner.”⁸ Yet, Marx also rejected “utopian socialists” who envisioned communities without divisions of labor and industrial technology. In his most explicit writings on this point, Marx predicted that industrial labor would remain unfulfilling even in a postcapitalist society. To maximize freedom and work satisfaction, he favored technological advances to increase productivity. With higher productivity, the workday could be shortened, leaving people with more free time for personal development.⁹ This strategy has been articulated more recently by Radical theorists such as Herbert Marcuse (1898–1979) and Andre Gorz (1923–2007).¹⁰

In contrast to the Marxian view, significant numbers of Radicals today insist that industrial labor can be made fulfilling by establishing democracy in the workplace so that workers gain control over the production process.¹¹ In these “co-ops,” workers would actively participate in the conception, implementation, and execution of all phases of production. To relieve

monotony and boredom, workers might continually master new skills and knowledge by rotating among different tasks within the factory. Worker control would not preclude delegating authority to democratically elected managers accountable to workers, but the workers would retain sufficient power to organize the production process in a manner that would foster personal development as well as efficiency.¹²

The Organization of Work

Radical explanations of the organization of work rest on Marx's distinction between labor power and labor. Labor power, or the ability to work, is the commodity sold by workers to capitalists in exchange for wages. In contrast, labor is the actual productive activity of workers. The purchase of labor power by capitalists does not guarantee a specific amount of labor to be performed, so capitalists confront the ongoing task of extracting as much labor as possible from their employees. Workers, knowing that capitalists reap most of the benefits of increased productivity, have little incentive to exert themselves. Faced with this resistance, capitalists establish hierarchical structures of authority to control the work process and increase the amount of labor performed. Hierarchy creates social distance and artificial barriers among employees occupying different strata within the firm. By creating competition for promotions, capitalists fragment the workforce into antagonistic groups, thereby undermining worker solidarity and suppressing wage costs.

Although capitalists establish hierarchical control to secure high productivity and low wages, Radicals argue that hierarchy actually reduces efficiency by adding extra layers of supervisory personnel, increasing antagonisms within the workplace, and precluding the adoption of technology relying on a cooperative and knowledgeable workforce. Understanding this argument requires a brief review of the Radical interpretation of labor history.¹³

According to Radicals, early capitalists introduced labor-saving technology to improve labor productivity and to reduce their reliance on skilled artisans and craft workers. These laborers understood the entire production process and could, therefore, potentially leave to start their own businesses. By breaking down skilled work into numerous routine tasks,

capitalists reduced many jobs to repetitive physical motions requiring no particular skill. As a result, capitalists gained a monopoly over knowledge of the production process and exercised arbitrary control over the organization and pace of work. As an added benefit for capitalists, wages were suppressed by the virtually limitless supply of unskilled labor. However, this strategy of “deskilling” labor created a new set of problems. The increasing homogeneity of the labor force contributed to workers’ growing sense of solidarity as they recognized their shared plight. To undermine solidarity among workers, capitalists began stratifying or segmenting the labor force, using distinctions based on race, gender, ethnicity, level of education, and credentials to “divide and conquer” workers.

Radicals claim that the organization of work under capitalism is guided by the drive to maximize profits rather than by efficiency. While Classical Liberals argue that competitive market forces make profit maximization synonymous with efficiency, Radicals claim that profit maximization and efficiency often diverge. Although hierarchy may be advantageous to the capitalist by increasing profits, it is inefficient and, therefore, contrary to the public interest.¹⁴

This debate between Radicals and Classical Liberals on the efficiency of the capitalist firm has been difficult to resolve. Empirical testing of the efficiency of different forms of work organization remains inconclusive because no two firms are identical in every respect except for hierarchical versus egalitarian organization of work. Also, efficiency ultimately hinges on the motivation of workers. Whereas Classical Liberals believe that workers will shirk their duties unless placed within a hierarchical chain of command and supervision, Radicals claim that humans want to perform meaningful work and that the implementation of more egalitarian and participatory forms of work would unleash the repressed talents and energies of workers.¹⁵ These conflicting beliefs are difficult to resolve because human motivation results from historical, cultural, and economic factors that vary over time and between societies.

Another difficulty underlying this debate between Classical Liberals and Radicals lies in disagreement over the meaning of “efficiency.” Classical Liberals define efficiency in production as cost minimization and, therefore,

argue that the same competitive market forces compelling firms to minimize costs will simultaneously enforce efficiency. Radicals, by contrast, define efficiency as input minimization—an efficient business produces goods using the fewest economic resources. Market competition may enforce cost minimization, but Radicals argue that capitalist firms actually use more labor per unit of output than would be needed by worker-controlled firms able to increase worker morale and to dispense with many supervisory positions.

To demonstrate the inefficiency of capitalism, Radicals point out that firms can potentially increase output without a corresponding increase in cost by hiring more supervisory personnel. Despite the additional salaries of supervisors, production costs may not rise if the supervisors are able to extract more labor from each worker. Although this strategy is efficient in terms of cost minimization, it uses more manpower and, therefore, is inefficient from a broader social perspective. Radicals conclude that hierarchy is inefficient because it fails to minimize the hours of labor used to produce society's goods and services. Democracy in the workplace would inspire and energize workers and, therefore, increase productivity without additional layers of supervisory personnel.

Radicals claim that capitalist firms would maintain a hierarchical organization of work even if it failed to minimize cost. The Classical Liberal argument that competitive market forces eliminate any inefficient hierarchies rests on the assumption that at least one “renegade” capitalist is willing to experiment with worker control. However, no capitalist has an interest in demonstrating the efficiency of worker control, thereby hastening the demise of capitalism. Capitalists realize that even if worker control could increase productivity, it would foster new forms of employee relations and consciousness threatening to capitalist ownership.

Classical Liberals respond to the foregoing argument by pointing out that if worker control were efficient, then groups of workers would obtain loans either to start their own businesses or to buy out their employers. Radicals, in turn, suggest two major obstacles to the establishment of worker-owned firms. First, banks and other lending institutions generally require significant collateral on large loans, effectively barring groups of workers from obtaining the financing to form their own businesses. Second, the alienating nature of most jobs in capitalism has conditioned workers to

doubt their own entrepreneurial and organization abilities. However, Radicals remain confident that through political struggles both within the workplace and throughout society, the superiority of worker-controlled and worker-owned firms will eventually become apparent.¹⁶

The Role of Unions

As industrialization accelerated in the late 19th century, Radicals concluded that only by acting collectively through unions could workers hope to challenge the concentrated power of capitalists. The success of moderate unions such as the American Federation of Labor resulted in part from employers' fears of more militant unions such as the Knights of Labor and the Industrial Workers of the World. By accepting moderate unions, capitalists undermined worker demands for greater control of the production process and instead steered workers toward "bread-and-butter" issues such as higher wages and better working conditions.

Radicals voice some criticisms of unions. They use the term "embourgeoisement" to describe the process by which union members have secured for themselves a comfortable standard of living while ignoring the plight of women, minorities, and nonunionized workers. Since the mid-20th century, unions have acted more to protect the interests of their members than to form the basis for a broad working class movement aimed at transcending capitalism.¹⁷ Unions also benefit corporations by assuring predictable labor costs so that long-term investment decisions can be made with greater confidence. For firms with considerable market power, any increase in wage costs can be passed on to consumers in the form of higher prices, meaning that union gains come partly at the expense of the rest of society.

Globalization of the economy has cast new light on the role of labor unions.¹⁸ Now, in addition to the inflationary impact of higher wages, unions may reduce a nation's ability to compete in international markets. Manufacturing, which was traditionally the most heavily unionized sector of the industrialized economies, has been devastated by outsourcing and relocation of production to lower-wage countries. The legal protections that once allowed unions to thrive within a single nation are being rendered obsolete by global competition. In light of these changes, Radicals now

look to unions to adopt a new role as organizers and representatives of the broad interests of the working class as a whole.¹⁹ With popular support, unions can gain sufficient political power to pressure governments to enact favorable labor legislation at the local, state, and national levels as well as international agreements to protect workers against exploitation, abuses of human rights, and unsafe working conditions throughout the world.²⁰

THE CONSERVATIVE PERSPECTIVE

The Nature of Work

Conservatives exhibit conflicting attitudes about work. Some appeal to the notion of “original sin” to argue that work is mankind’s punishment for defying God’s will and is, therefore, inherently unpleasant. The psychologist Sigmund Freud (1856–1939) reinforced the negative image of work by portraying it as the repression of pleasure.²¹ However, most Conservatives view work as honorable and fulfilling when it is performed within a “natural order” in which hierarchical structures of authority mesh smoothly with the varying natural abilities of individuals. When workers engage in occupations appropriate to their abilities and social status, they can take pride in even the most menial tasks because all jobs contribute to the effective functioning of society. Conservatives believe that humans develop their talents and find purpose in their lives only in the context of social structures such as families, churches, neighborhoods, and civic organizations. By offering an opportunity to participate in the community, work enables individuals to achieve personal identity and self-esteem.

Like Radicals, Conservatives believe that the natural human desire for productive labor has been corrupted by the individualism, materialism, and the erosion of community associated with modernization. When the pursuit of wealth and social status is the focus of people’s lives, work becomes a demeaning ritual to be endured in order to achieve material success. Work loses its intrinsic worth and becomes merely a means to an end. Because the pursuit of wealth has no limits, even successful individuals may be dissatisfied with their standard of living. The competition for wealth and status leads to conflict, hostility, and personal insecurity. This discontent

erodes the traditional community bonds essential to social order and stability.

Conservatives want to restore the dignity of work. To achieve this goal, they propose the formation of occupational groups to provide workers with a sense of belonging and community. This idea dates back to the guilds of medieval Europe and was renewed in the late 19th century by the Catholic Church. In 1891, Pope Leo XIII issued an encyclical entitled “*Rerum Novarum*” that called for vocational groupings of workers. Church leaders sought to mediate the conflict between workers and employers by having representatives of workers, employers, and government engage in peaceful negotiations and thereby develop an alternative to both socialism and free-market capitalism. This “state corporatism” was adopted in heavily Catholic countries such as Spain, Portugal, and Brazil during the 1930s and 1940s.²²

Other Conservative strategies for improving working conditions include restrictions on free international trade to protect workers in the industrialized countries from competition with cheaper foreign labor. Some Conservatives anticipate that technological advancements may eliminate much of the routine drudgery associated with work. Sociologist Daniel Bell (1919–2011) envisioned a “postindustrial society” in which all citizens would have opportunities for stimulating work as well as increased leisure.²³

The Organization of Work

Conservatives believe that hierarchical structures of authority are essential within businesses and throughout society. They offer the following explanations for the emergence and persistence of hierarchy:

1. *Differences in ability.* Humans are endowed with a wide range of temperaments, intelligence, and physical capabilities. To function smoothly, work must be structured to provide appropriate roles for individuals’ differing abilities. Conservatives believe that leadership skills, including wisdom, virtue, and charisma, are found in only a small minority of the population who should naturally assume leadership positions. Those with more physical strength will perform manual labor, those with interpersonal skills will be employed in the service industries, and those with strong

intellectual abilities will work as professionals. The sociologist Talcott Parsons (1902–1979) emphasized the “functionality” of hierarchy in supporting social order.²⁴

2. *Smooth social interaction.* Authority and hierarchy are essential to human relations because they provide predictability and stability. Without a clear chain of command, individuals may become confused about their rights and duties. Human interaction may degenerate into mass deference in which everyone looks to someone else for leadership. Alternatively, social relations may become a struggle for dominance, with each person refusing to acknowledge the authority of anyone else. In a well-organized hierarchy, leaders recognize the extent of their authority and subordinates realize their duties. Humans learn the traditional rights and responsibilities attached to their social roles, enabling them to behave appropriately.

3. *Role models.* Hierarchy places elites in visible positions to serve as role models for the rest of society. Much of human development is based on social mimicry; we learn how to behave by observing others. Therefore, all citizens benefit from prominent displays of talent and virtue by those at the top of the social hierarchy. Conservatives lament the increasing moral lapses of prominent leaders in politics, business, sports, and entertainment. These transgressions are symptomatic of a society experiencing moral decay, and they accelerate the process by creating cynicism and disillusion among all citizens.²⁵

4. *Identity formation.* Conservatives claim that humans need clear distinctions in social status in order to form personal identities. They blame much of the conflict in modern societies on the weakening of traditional social hierarchies. An egalitarian society makes identity formation more difficult by fostering a “mass society” in which individual personalities become homogenized. Conservatives attribute the rise of totalitarianism in the form of communism and fascism in the 20th century to the decline of traditional hierarchies and communities that left individuals isolated and receptive to demagogues promising to restore the strength of communities and nations.²⁶

The Conservative support for hierarchy does not extend to all forms of stratification found in modern societies. The massive dislocations wrought by industrialization and liberalism have generated concentrations of power inconsistent with the “natural order.” By unleashing the acquisitive desire for wealth and power, liberalism has transformed society into a free-for-all scramble for material gain. The resulting aversions to self-discipline, loyalty, and commitment cause workers to shirk their duties on the job. To effectively monitor work performance, managers and owners must routinize the work process, which leads to further alienation as workers lose the sense of self-worth they once gained from their labor. Conservatives believe that a “natural order” would entail less hierarchical control of the work process because employees would take pride in doing their jobs well.

Some Conservatives have proposed experiments with worker participation and cooperation to restore the integrity of work. Early Conservatives such as Thomas Carlyle (1795–1881) shared with Radicals a strong opposition to the rigid division of labor accompanying the emergence of capitalism. They believed that treating employees like cogs in a machine would undermine workers’ humanity and destroy the social fabric of communities. However, unlike Radicals, Conservatives favor worker participation only to the extent that it remains cooperative and respectful of the prerogatives of management and owners. Hierarchy is still needed to accommodate individuals’ differing abilities, but it should not be so great as to diminish workers’ pride and motivation in doing their jobs well.

The Role of Unions

Conservatives are critical of labor unions in their present form. Unions disrupt the natural order by challenging the authority of managers. Like other groups pursuing narrow self-interest, unions manage to secure material gains for their members while ignoring the effects of higher wages and lower productivity on the health of the economy. However, Conservative support for the idea of occupational groups could extend to labor unions that focus less on gaining control over wages and more on integrating workers into a community offering a sense of belonging and purpose.²⁷

A recurring Conservative critique of modern society is that industrialization has eroded communities, leaving individuals isolated with few social networks. As the ideology accompanying industrialization, liberalism validates the loss of community by emphasizing individual autonomy, materialism, and freedom from social and political constraints. However, a society without healthy communities becomes fragmented as individuals lose meaning and purpose in their lives. Labor unions could be important “intermediate institutions” along with churches, clubs, and neighborhoods to create new communities and reintegrate individuals into social groups. Conservative labor unions would work cooperatively with business and government to promote a unified vision of society’s goals.

THE MODERN LIBERAL PERSPECTIVE

The Nature of Work

In the early stages of industrialization, Modern Liberals largely accepted the Classical Liberal view of work as unpleasant and motivated only by monetary incentives and threats of discipline. However, by the 20th century, Modern Liberals observed that technological advances were eliminating many menial tasks so that work could become a source of personal satisfaction and fulfillment. By raising productivity, technology would also permit a shorter workday and rising wages, so workers would enjoy increasing opportunities for personal development outside their jobs.

Recognizing the changing nature of work, psychologist Abraham Maslow (1908–1970) developed the concept of a “hierarchy of needs.”²⁸ Once basic needs for nourishment and physical safety are met, humans shift their energies to fulfilling higher needs such as love, self-esteem, high-quality social relations, and, ultimately, “self-actualization,” the achievement of one’s full potential. For Maslow, meaningful work that develops and engages a broad range of human capacities is essential for self-actualization.

Unfortunately, according to Modern Liberals, unregulated capitalism creates competitive pressures on employers to maximize profit by dividing

labor into narrowly specialized tasks, by paying the lowest possible wages, by resisting efforts to shorten the workday, and by failing to provide safe working conditions. As globalization has unleashed market forces from many of the constraints posed by domestic regulations, the quality of the work experience in modern society is deteriorating as employers intensify demands on workers and reduce benefits.²⁹

The Organization of Work

Frederick Taylor's principles of "scientific management" emerged in the early 20th century when most workers had little education and viewed their jobs primarily as a means of providing food and shelter for themselves and their families. However, as workers became more educated and their standards of living rose, they began to resist the tightly supervised, mindless routines called for by "scientific management." In response, management theorists such as Elton Mayo (1880–1949) and Kurt Lewin (1890–1947) developed a new "human relations" approach to organizing work.³⁰ For Mayo and Lewin, the key to eliciting high productivity from workers lay in structuring the production process in ways that satisfied the human needs for respect, autonomy, a sense of belonging, and opportunities to advance. If workers are satisfied with their environment, they will cooperate with management in achieving the firm's goals.

To "humanize" the workplace, Mayo and Lewin recommended that each worker be given a variety of different tasks rather than the narrow specialization associated with "scientific management." With workers more involved in and knowledgeable about production, layers of supervisory personnel could be eliminated. Less monitoring by supervisors demonstrates management's trust and confidence in workers. When workers feel valued and respected, they become more productive, viewing their jobs as opportunities for personal development rather than simply a means to earn a living.

Modern Liberals acknowledge that some degree of hierarchy is needed to organize work effectively. Even highly motivated workers require clear lines of authority for processing information and communicating decisions. Hierarchy makes clear the extent of authority and responsibility attached to each role in the workplace.³¹ However, Modern Liberals anticipate that

hierarchy may diminish as economic development advances. The present need for hierarchy derives, in part, from poverty and discrimination that leave many workers inadequately prepared for self-directed work. Indeed, the “human relations” approach to management is typically confined to large corporations employing a highly educated and well-paid workforce. Smaller firms tend to rely on hierarchical organizations of work because their lower pay scales reduce the motivation of their employees. Modern Liberals conclude that hierarchy can be minimized by combating the poverty and discrimination that prevent many workers from developing positive attitudes toward work.

In response to the Classical Liberal argument that market competition will force firms to adopt the most efficient organization of work, Modern Liberals make two arguments. First, markets are never perfectly competitive, and firms with substantial size and market power may survive despite inefficiently hierarchical structures of authority. Second, efficiency is not the sole criterion by which to assess the organization of work. Other values such as individual autonomy, justice, and human development may conflict with efficiency, and some sacrifice of efficiency may be warranted to improve workers’ level of job satisfaction. The market’s pressure to focus solely on efficiency can be overridden by establishing legal rights to aspects of work such as occupational health and safety, a livable wage, limited working hours, and protection against discrimination. The enforcement of these rights requires government mandates limiting the freedom of firms to increase profits by taking advantage of their power over workers. In summary, Modern Liberals will sacrifice some efficiency in the pursuit of other valued social goals, but they also remain optimistic that humanization of the workplace can be largely consistent with increased productivity and profitability.

The Role of Unions

Modern Liberals support labor unions as a necessary balance to the concentration of business power. Even Classical Liberal economist Adam Smith observed that employers always maintain the upper hand in bargaining with workers because workers need their jobs in order to survive. Prior to the emergence of labor unions, employers could easily hire

workers at subsistence wages and fire them at will. Owners held arbitrary power over workers rendered defenseless by fierce competition for jobs. Modern Liberals view labor unions as a “countervailing power” to level the playing field as workers negotiate with employers over wages and working conditions.³²

Following extensive labor unrest during the Great Depression, enlightened corporate leaders accepted organized labor and supported government efforts to promote unionization.³³ When U.S. advisors arrived in postwar Germany and Japan, they insisted that strong labor unions were essential to rebuilding war-torn economies. Union contracts assure predictable wages so that investment decisions can be made with greater certainty about future costs. Unions usually agree not to strike during the length of the contract, and union officials may discipline less productive workers. By raising wages, unions encourage corporations to adopt more capital-intensive technology, thereby increasing productivity.

The Modern Liberal defense of labor unions received a tremendous boost from Keynesian economics. Whereas Classical Liberals claimed that higher wages would restrict economic growth by raising production costs and reducing profits, Keynes argued that low wages led to insufficient spending and, therefore, restrained growth. If wages rose, workers would possess more disposable income, and their increased spending would stimulate production, employment, and growth. From the Keynesian perspective, the entire economy benefits from the power of labor unions to secure a more equal distribution of income. Keynes also predicted that economic growth and technological developments might raise productivity to the point where only three hours of work per day would be sufficient to secure a comfortable standard of living.³⁴ However, without pressure from labor unions and government, market competition would prohibit employers from voluntarily shortening the workday.

In the decades following World War II, unions stood at the height of their power, the economy prospered, and millions of workers rose into the middle class. Modern Liberals claim that unions benefit all workers because many nonunionized firms pay close to union wages in order to maintain employee morale and to discourage the spread of unions. In addition, unions use their political clout to secure legislation such as minimum wage

laws and occupational safety laws that apply to all workers.³⁵ In response to Classical Liberal claims that unions cause inflation, Modern Liberals argue that corporate efforts to raise profits are the primary cause of “cost-push” inflation. The fact that real wages in the United States have been relatively stagnant since the 1980s indicates that union demands for higher wages are typically efforts to match the rising cost of living initiated by corporate price increases.

As globalization and international competition have intensified in recent years, some Modern Liberals have tempered their support for labor unions. Many of the original issues propelling unionization, such as workplace safety and nondiscrimination, have been largely resolved through government regulations. Moreover, the Keynesian argument that high wages boost consumer spending and therefore benefit the economy is now partially invalidated by the effect of high wages in weakening the ability to export. As competitive pressures from abroad force corporations to negotiate more aggressively with unions, workers sometimes make concessions of previous gains. Modern Liberals now expect unions to be prudent and responsible in their wage demands and to cooperate with management in the adoption of labor-saving technology.

Organized labor has lost substantial power during the past half century. The combination of global competition, chronically high unemployment, and less-supportive government policies has placed workers throughout the world on the defensive. Manufacturing, traditionally the most heavily unionized sector, has declined, and workers in the expanding high-tech and service industries are less inclined to join unions.³⁶ In the United States, only 5 percent of nonagricultural private sector workers belong to labor unions. Despite current setbacks, Modern Liberals continue to defend unions as essential to maintaining middle class standards of living and protection against arbitrary power in the workplace. They express confidence that a renewal of labor unions is both necessary and possible.³⁷

NOTES

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Chapter 11

Minorities and Discrimination

Political economists often disagree about the meaning of the term “discrimination.” For example, does wage discrimination occur only when hiring and promotion decisions result in equally productive employees being paid differing wages, or should the concept of discrimination also include the cultural and institutional forces affecting both employees and employers prior to labor-market activities? The broader conception of discrimination is more difficult to assess because individual family backgrounds, quality of schools, neighborhood environments, and societal attitudes toward minority groups must be considered. Even the narrow definition of wage discrimination as unequal pay for equally productive workers requires a method for measuring individual productivity. Economists typically rely on level of formal education as a proxy for productivity, with discrimination assessed by comparing the relationship between average adult wages and average length of schooling for different racial and ethnic groups. However, numerous other variables affect productivity, including such unmeasurable factors as individual initiative and motivation. Empirical efforts to verify the extent of discrimination are limited by the inadequacy of statistics in capturing all the determinants of productivity.

At the center of much of the controversy surrounding the issue of discrimination is “affirmative action,” a program encouraging employers to establish goals for minority employment and to vigorously search for qualified minority candidates. Each of the four ideological perspectives offers dramatically different views on discrimination and affirmative action.

THE CLASSICAL LIBERAL PERSPECTIVE

Explanations of Discrimination

Reflecting its origins in the struggle of merchants and manufacturers to free themselves from oppressive control by church and state, Classical Liberalism upholds the right of all individuals to compete freely in the market. Classical Liberals affirm civil rights as protection against harm by the government or by other citizens, but they do not view discrimination as a violation of civil rights unless it occurs within a public institution or facility. For example, while they oppose laws prohibiting minority persons from riding city buses or attending public schools, Classical Liberals defend the right of private individuals and firms to select their customers, employees, and associates. Freedom to choose includes freedom to exclude, so laws requiring individuals or firms to transact with minority persons violate freedom and the rights attached to private property.

Although Classical Liberals defend the right to discriminate, they claim that a free market is the best solution to discrimination because it distributes income in accordance with productive contribution and penalizes bigotry.¹ A bigoted employer with a “taste for discrimination” may refuse to hire minority workers despite their willingness to work for lower wages. Yet, if markets remain competitive and the productivity of minority workers equals the productivity of other workers, the bigoted employer will sacrifice some profit by paying higher wages than necessary. Other nonbigoted employers will hire minority workers at lower wages, thereby earning more profit or selling products at lower prices. Over time, the cost advantage gained by nondiscriminating firms will cause bigoted employers to lose market share and perhaps face bankruptcy. Eventually, competition among nonbigoted

employers will bid up wages for minority workers and discrimination will disappear. Classical Liberals conclude that the pursuit of profit is more powerful than prejudice in motivating human behavior.

To measure the extent of discrimination, economists attempt to assess the “rate of return” for investments in education among different racial and ethnic groups. This concept is a measure of the additional future income attributable to increased years of schooling. Empirical data do reveal lower rates of return for minority persons, but Classical Liberals argue that education is only one of many variables affecting a person’s productivity and income. The “pay gap” between workers from different racial and ethnic groups drops significantly when the measurement of productivity includes other variables such as quality of education, geographic location, and job experience. In addition, the effect of intangible factors such as family background, self-motivation, and self-discipline is nearly impossible to measure, so statistical evidence of a racial pay gap cannot be taken as proof of discrimination.

Classical Liberals believe that the free market will not sustain discrimination and suggest that the lower economic status of minority groups may be due to lower productivity, which, in turn, reflects either lower ability or a preference for leisure and immediate gratification. However, this conclusion creates a dilemma for Classical Liberals. While they acknowledge that the historical evolution of different races in separate parts of the world may have led to quite different genetic endowments, any claim that minority persons are innately less productive opens Classical Liberals to charges of racism.² In contrast, if abilities and preferences result from social conditioning, then humans are not the autonomous, rational utility maximizers portrayed in neoclassical economic theory. To avoid this dilemma, Classical Liberals attribute persistent discrimination to imperfect competition. When competition is weak, employers can afford to discriminate because they face less pressure to minimize wage costs. Extending this argument, Classical Liberals claim that imperfect competition is largely caused by government intervention in the market with regulations that suppress or discourage the entrance of new firms and workers. For example, minimum wage laws and antidiscrimination laws force employers to pay the same wages to unskilled workers regardless of

race or ethnicity. As a result, employers face no financial penalty in terms of lower profits for indulging their “taste for discrimination.” The conclusion reached by Classical Liberals is that government, not the market, is ultimately responsible for persistent discrimination.

Three Classical Liberal economists have separately developed the argument that government intervention, not bigotry and discrimination, is responsible for the lower economic status of minority groups in the United States. Thomas Sowell claims that government policies aimed at combating the effects of discrimination are unnecessary and actually detrimental to minorities.³ As a result of antidiscrimination statutes and affirmative action programs, employers hire only the most highly qualified minority workers in order to minimize the likelihood of subsequent layoffs and resulting lawsuits. Government pressure to hire minorities creates a dual labor market as the gains of more educated minority workers come at the expense of those with fewer credentials. Segmentation of the minority labor market is evidenced by the fact that African American female professionals earn more than their white counterparts, while African American high school dropouts earn considerably less than their white counterparts.

Walter Williams argues that legislation requiring equal pay for black and white workers in the same job actually closes off opportunities for minority workers because employers no longer face the penalty of paying higher wages to hire only white workers. As an example of a government-imposed barrier to minority advancement, Williams cites New York City’s licensing fee of nearly \$1 million to own and operate a taxi. The cost of the licenses effectively prohibits most minority persons from entering that line of business. In addition, municipal zoning laws and housing codes raise property values and effectively prevent low-income minority persons from moving into certain neighborhoods. If government would allow the market to operate freely, the talents and ingenuity of minority persons would enable them to rise from poverty.⁴

Glenn Loury acknowledges that much of the responsibility for minority poverty lies with the attitudes, values, and behavior often found within minority families and communities. However, he ultimately blames government welfare programs for undermining the initiative of minorities and creating dependency that is passed on from one generation to the next.

Loury is particularly concerned about the decline of the traditional nuclear family in African American communities, and he blames welfare programs that are more accessible to single mothers than to families headed by males.⁵

To summarize, Classical Liberals largely deny the existence of discrimination, arguing that most of the pay gap between majority and minority workers results from differences in productivity. These differences may be inherited genetic characteristics or cultural norms, but Classical Liberals prefer to emphasize the role of individual attitudes and values. Those individuals unable or unwilling to make productive contributions in the market are treated fairly when their rewards are correspondingly small. If discrimination does occur, government bears the blame because it perpetuates the plight of minority groups by providing welfare programs that reward irresponsible behavior, by posing legal obstacles to the advancement of minority persons, and by facilitating monopolistic concentrations of power that shield discriminators from the disciplining force of competition.

Responses to Discrimination

Since Classical Liberals view competitive markets as the best defense against discrimination, they propose that government should eliminate most regulations on business activity. They also would abolish most government aid to minority groups, viewing such assistance as undermining self-reliance and ambition. Without assistance from government, minority individuals would be motivated to acquire more skills and work more diligently.

For Classical Liberals, equal opportunity means equal treatment under the law so that no individual or group is either advantaged or disadvantaged by government policies. In other words, laws and policies should be “color-blind,” affecting members of all groups equally. Any reference to race, religion, gender, or ethnic background in laws is discriminatory. In particular, affirmative action is simply “reverse discrimination” against nonminority members of society. Affirmative action creates resentment among majority workers and reinforces a sense of entitlement and victimhood among minorities that undermines personal responsibility.⁶

Affirmative action also fosters inefficiency by disrupting the market's allocation of workers to jobs for which they are qualified.

Classical Liberals support publicly funded education to assure equal opportunity for all. When markets are free and avenues for acquiring human capital are open, Classical Liberals believe that prejudice and bigotry will subside. They point to increasing opportunities for minorities in professional and managerial positions as evidence that discrimination is declining.⁷ Eventually, equality of opportunity and free markets will create a society in which individuals are rewarded solely on the basis of the productive contribution of their resources.

THE RADICAL PERSPECTIVE

Explanations of Discrimination

Prior to capitalism, most individuals lived in relatively homogeneous communities in which they played a variety of overlapping roles. The rise of industry and commerce, however, decimated the social fabric of medieval society by turning labor into a mobile economic commodity used according to the dictates of profitability. Increasingly, workers found themselves performing very routine tasks surrounded by others with whom they shared little sense of tradition or community. Social relations grew more impersonal as self-interest began to dominate human interactions. Society became simply an aggregation of isolated individuals pursuing private goals. Humans increasingly viewed each other as rivals and potential threats in the competitive struggle for survival.

While Radicals claim that capitalism bears much of the responsibility for generating racial and ethnic conflict, they also defend capitalism as a progressive force in integrating diverse groups. In the pursuit of profit, capitalists will transcend barriers between nations, ethnic groups, and races so that commerce can proceed smoothly in a unified global market. Radicals half-jokingly claim that the leading proponents of “one-world government” are not communists but instead the CEOs of multinational corporations who seek to end nationalist, racial, and religious hostilities impeding the free flow of resources and products. Capitalism breeds civility

toward strangers by bringing diverse cultures into contact with one another and by making each person's livelihood dependent on peaceful transactions with others.

Radicals resolve the seeming inconsistency of both praising and condemning capitalism by appealing to the dialectical logic developed by the German philosopher G.W.F. Hegel (1770–1831). In his view, apparent opposites actually comprise parts of a larger unity. Because the accumulation of capital is the primary force underlying capitalism, racial and ethnic distinctions will diminish when they obstruct capital accumulation. For example, during the half century after the Civil War, the U.S. economy successfully absorbed millions of foreign immigrants whose labor kept wages low, thereby increasing the accumulation of capital. Similarly, the Civil Rights movement in the United States was aided by the perception among influential members of the ruling class that continued segregation would jeopardize social order and profitability.

In contrast, maintaining racial and ethnic distinctions may also promote capital accumulation by segregating the labor force, thus legitimizing a hierarchical division of labor wherein minorities are consigned to the most menial jobs. Race and ethnicity create distinct and identifiable groups in society. If the poor and unemployed are perceived as “the other,” their plight appears natural and, therefore, less troubling to the majority. Moreover, the frustrations of lower-class white workers are diffused by the knowledge that they remain relatively successful compared to minorities.

Although capitalism has accomplished significant integration of the global population, the annexation of new sources of labor typically occurs under extremely inequitable conditions. Minority groups often find themselves ushered into the capitalist economy as cheap labor, so despite capitalism's potential for integration, the accumulation process often subordinates, exploits, and discriminates against newly assimilated groups. Slavery was the most egregious example of exploitation of minorities, but even after slavery ended, millions of African Americans continued to live in conditions resembling slavery. The “share cropping” system enabled white land owners to gain workers in exchange for part of the harvest. With large number of ex-slaves desperate to support themselves, they had little bargaining power and most of the harvest went to the land owners—a result not much different from conditions under slavery. As African Americans

began migrating northward in search of better opportunities, labor in the South became scarcer and some areas began the practice of “debt peonage.” An African American would be arrested for a petty offense such as loitering or vagrancy and sentenced to work on a local plantation in exchange for food and shelter. Again, the end result resembled slavery.⁸

Radicals note that employers can actually benefit from hostility among racial and ethnic groups because it weakens worker solidarity and bargaining power. Reliance on a “divide and conquer” strategy was exemplified by the past practice of using black workers as strike breakers to motivate whites to return to work. The lack of unionization and bargaining power among minority workers left them vulnerable to exploitation and relegated them to the most menial jobs at wages barely sufficient to survive.⁹

Much of the hostility directed toward minorities arises from the perception that they pose a threat to the wages and job security of majority workers. However, Radicals believe that this antagonism toward minorities is misdirected. Empirical research by economist Michael Reich found that cities in which black wages lagged farthest behind white wages also tended to have the lowest wages for unskilled white workers, the highest profit rates, and the least amount of unionization.¹⁰ Reich’s research indicated that employers were the primary beneficiaries of discrimination, while white workers benefited from the increased solidarity and bargaining power provided by greater racial equality and unionization.

Another Radical explanation for the lower economic status of minorities is based on the concept of segmented labor markets. During the late 19th and early 20th centuries, as new immigrant populations were annexed into the capitalist economy, employers began reducing many tasks to simple routine motions that could be performed by workers with little training or experience. This “de-skilling” of labor created an increasingly homogeneous labor force and led to a sense of solidarity among workers resulting in demands for higher wages and better working conditions. In response to this militancy, capitalists stratified the workforce by segmenting various occupations within firms, thereby creating a “dual labor market” consisting of a primary sector including high-paying jobs and a secondary sector offering only low-paying jobs for unskilled labor.¹¹

This historical change in the structure of labor markets substantially affects the economic status of minority workers. Often forced to begin their work-lives in the secondary sector, minority workers experience low wages, bad working conditions, and lack of opportunity for advancement. As a result, they develop patterns of absenteeism, frequent job changes, and poor productivity. But their low productivity results from their working conditions rather than any lack of ability. The very nature of work in the secondary sector causes workers to become unfit for employment in the primary sector.

To summarize, Radicals blame capitalism for creating a systemic and institutionalized system of power in which wealth accumulates at the expense of subordinate groups in society. Because maintaining this power structure enhances profitability, the competitive forces of the market will fail to secure equal opportunities for all citizens. At the same time, by integrating and homogenizing different racial and ethnic groups, capitalism creates the potential for a united working-class political movement. The balance of these two contradictory forces will affect the long-term viability of capitalism.

Responses to Discrimination

Radicals propose three broad strategies for combating discrimination and elevating the economic status of minorities. First, they encourage the formation of interracial coalitions to pressure employers and the government for programs to overcome the effects of discrimination. Radicals argue that both majority and minority individuals have much to gain through cooperation. For example, during the 1930s, the Congress of Industrial Organizations (CIO) made a concerted effort to include black workers in its unionization drives. As a result, the CIO achieved significant bargaining power and dramatic success in raising wages and improving working conditions for millions of laborers. The Civil Rights movement of the 1960s provides another example of an interracial coalition yielding gains for all citizens.

The second component of a Radical program to combat discrimination consists of government policies to promote full employment and economic growth. Without growth, the gains of one group come at the expense of

another, and the economy is a zero-sum game. Similarly, unemployment exacerbates racial and ethnic tensions as employed workers feel threatened by the unemployed who are eager to take over their jobs. With growth and full employment, the formation of interracial coalitions should proceed more rapidly. Although most Radicals, including African American activists such as Angela Davis and Cornel West, support black–white coalitions, other Radicals such as Malcolm X (1925–1965) and Louis Farrakhan have urged minorities to separate from white society by establishing their own political parties and economic institutions.¹²

Finally, Radicals propose that racial relations will improve in a postcapitalist society in which ownership of resources is more equitably distributed and markets have been firmly embedded in a regulatory framework. Radicals believe that the formal equality established by legal bans on discrimination cannot create equal opportunity when ownership of resources remains highly concentrated in the hands of the white majority. The extremes of wealth and poverty in capitalism create the very behaviors, resentments, and prejudices that perpetuate discrimination. In short, equality of opportunity requires not just formal equality under the law but also greater substantive equality in the ownership of resources.¹³ One proposal for accomplishing greater equality is to grant “reparations” to African Americans in acknowledgment of the damage perpetuated by slavery not only to slaves themselves but also to their descendants.¹⁴ The notion that an entire society should atone for past injustices has a long history dating back to the unfulfilled promise by the U.S. government that every ex-slave would receive “forty acres of land and a mule” as part of the reconstruction following the Civil War.

Radicals acknowledge that minorities fared poorly in many of the past experiments with forms of socialism based on central planning and government ownership of the means of production. If markets are replaced by planning, the absence of competition leaves employers and bureaucrats free to discriminate without the penalty of paying higher wages to employ majority workers. Even if markets are retained in socialism, firms owned by workers or communities could continue to discriminate as exemplified by the ethnic hostilities in socialist Yugoslavia during the latter part of the 20th century.

Radicals respond to these arguments by pointing out that past experiments in postcapitalist societies took place only in relatively underdeveloped countries lacking industrialization and modernization. As a result, the cultures of those countries remained linked to their recent pasts as quasifeudal societies. Radicals remain confident that the homogenizing and integrative forces of capitalism can effectively lay the groundwork for a postcapitalist society in which solidarity and cooperation among diverse groups will prevail.

THE CONSERVATIVE PERSPECTIVE

Explanations of Discrimination

The Conservative vision of the ideal society as a hierarchical community appeals to those who favor racial and ethnic segregation. Although racists are often Conservative, the principles of Conservatism do not necessarily support discrimination. However, a few prominent Conservative theorists have proposed that members of some minority groups are intellectually inferior to Caucasians. William Shockley (1910–1989), who invented the transistor and won a Nobel Prize in 1955, Arthur Jensen (1923–2012), Richard Herrnstein, and Charles Murray have pointed to lower scores on IQ tests as evidence of reduced mental capacity among minorities.¹⁵ While the differences in test scores are indisputable, Modern Liberals and Radicals dismiss IQ tests as biased measures of those aptitudes nurtured by the dominant culture. More generally, the critics challenge the very notion of innate or objectively measurable intelligence.¹⁶ Since intelligence is usually measured by the ability to manipulate symbols in a manner judged to be correct by a specific culture, aptitudes associated with intelligence in one culture may lack significance in another. Therefore, no single test can objectively measure intelligence across cultures.

Those Conservatives regarding minorities as innately inferior offer several explanations for discrimination. They claim that discrimination is simply the selection of the superior over the inferior and, as such, is neither immoral nor unjust. Also, discrimination and segregation discourage interracial marriages, which would result in “deterioration” of the gene

pool. Finally, segregation protects the cultural achievements of the majority from the less-developed cultures of minorities.

Nonracist Conservatives offer different explanations of discrimination. Because many minority groups originated in parts of the world where capitalism was late to arrive, their cultures may not value behaviors such as initiative, punctuality, and delayed gratification that contribute to success in a capitalist society. If these cultural differences create barriers to social interaction with the majority group, employers may be reluctant to hire workers from minority groups because productivity often depends on the ability to function well within the dominant culture.

Even nonracist Conservatives may oppose racial and ethnic integration by stressing the importance of maintaining the integrity of various cultural heritages within a pluralistic society. Race and ethnicity create meaning and identity for individuals and forge strong social bonds preserving cultures and communities. Conservatives may condemn integration for leading to a “mass society” in which individuals lose their unique identities and culture is homogenized.

Conservatives reject the Enlightenment vision of a universal community, the “brotherhood of mankind,” in which equally free and rational individuals pursue their interests in peace and harmony. By treating all persons as equals, the universal community fails to sustain the senses of uniqueness, rootedness, and belonging needed for full human development. Conservatives fear that modern society absorbs minority cultures into a homogeneous mainstream representing no particular culture. The individualism and mobility of mass society deprive everyone of a sense of community. Only closely knit, local communities, with all their prejudices, parochialism, and traditions, can provide socially-defined roles through which individuals find meaning and purpose in their lives. Mass society causes isolation and alienation, leading to a nation of pleasure seekers prone to frustration and violence when pleasure proves elusive in the absence of social bonds.

From the Conservative perspective, efforts to integrate society are actually harmful to minorities. Those who attempt to assimilate into mainstream culture face a dilemma. Failure to assimilate results in loss of self-esteem, while success breeds alienation as minority persons lose the security of their own culture but cannot completely identify with the

dominant culture. Some Conservatives urge minority groups to develop separate communities and business enterprises to sustain their cultural heritage. The separate social groupings established by racial and ethnic pluralism would function as “intermediate institutions” providing a sense of identity and belonging.

As evidence that segregation is a natural phenomenon among humans, some Conservatives point out that different racial and ethnic groups originally lived in separate geographical areas. People seem inclined to associate with others who share their culture, experiences, and values as evidenced by voluntary student segregation of cafeterias at some racially integrated schools. Racism may be part of our genetic inheritance as early human survival depended on quickly distinguishing between friendly members of one’s own tribes and potential threats posed by members of other tribes. Finally, Conservative theorist Edmund Burke praised the role of “prejudices” in establishing instinctive loyalty to particular groups and values so that individuals can act spontaneously without carefully assessing every judgment they make.

Responses to Discrimination

Conservatives are less concerned with alleviating discrimination than with reestablishing segregation to minimize interaction between different racial and ethnic groups.¹⁷ Those Conservatives who appeal to the innate inferiority of minorities may favor the practice of eugenics, which involves social control of human reproduction through sterilization of “deficient” persons and selection of “superior” persons for breeding. For example, government could require sterilization for individuals applying for welfare assistance so that their “inferior” genes would not be passed on in the gene pool. The Nobel Prize–winning physicist William Shockley sought to promote selective breeding by establishing a sperm bank for Nobel Prize winners.

Many Conservatives would like to end all government efforts to promote integration. Groups sharing sufficiently common cultural heritages will assimilate spontaneously, so if government coercion is required, Conservatives conclude that integration is unnatural. Government should act only to protect the rights of minorities against the “tyranny of the

majority” as exemplified by the former South African government’s policy of apartheid, which maintained racial segregation to preserve the culture and power of the white minority. When government forces integration, it creates a backlash of resentment from members of the majority and a flood of “rising expectations” from minority persons who look to government to provide them with a better quality of life.

Most Conservatives also oppose government programs to benefit minorities because any perception that one group is being favored at the expense of others serves to undermine respect for governmental authority. This opposition to public assistance for minorities also extends to affirmative action policies. Like Classical Liberals, Conservatives view affirmative action as “reverse discrimination” and warn that it generates animosity among whites toward minority groups. In addition, Conservatives claim that affirmative action damages the psyches of minority persons by tainting their accomplishments; they can never know whether their achievements are attributable to ability and effort or are simply the result of preferential treatment.¹⁸

Those Conservatives who accept some government efforts to alleviate poverty and unemployment among minority groups have proposed an alternative to welfare and affirmative action. Government would designate inner-city neighborhoods as “enterprise zones” and grant tax breaks and other financial incentives to promote businesses in those areas.¹⁹ Conservatives claim that this policy would restore the viability of minority neighborhoods by fostering local initiative and entrepreneurial energy. Conservatives have borrowed the leftist term “empowerment” to describe policies encouraging economically deprived individuals to lift themselves out of poverty.

In defending segregation, Conservatives are resisting strong historical currents. Since the Enlightenment, modern thought has been critical of ethnically and racially pure communities as stultifying, repressive, and intolerant. However, Conservatives claim that a cohesive, homogeneous community enables individuals to form emotional attachments to persons and places that form the basis for personal identity. Freedom, Conservatives argue, is potentially disruptive unless individuals have purpose in their lives, and genuine freedom flourishes when people are enmeshed in a web

of mutually supportive social relationships provided by racial and ethnic identity and other intermediate institutions.

THE MODERN LIBERAL PERSPECTIVE

Explanations of Discrimination

Modern Liberals trace the origins of racial and ethnic conflicts in industrial societies to the oppressive conditions under which most minority groups arrived. Having started in a disadvantaged position, minority persons are caught in a debilitating cycle; a deprived background restricts opportunity for acquiring skills, which, in turn, results in employment in menial jobs, low income, and the perpetuation of poverty. Blending Classical Liberal and Radical themes, Modern Liberals acknowledge that the plight of minority groups partially results from personal choices concerning education and employment, but they argue that these decisions are shaped by a social system structured around the on-going subordination of minority groups. In other words, discrimination is not simply the result of racist attitudes or unequal abilities but is also perpetuated by the institutional structure of an unregulated market economy. This “institutional racism” requires government policies and reforms to promote equal opportunity and cultural diversity.²⁰

Modern Liberals doubt the free market’s ability to end discrimination. They view the market as an arena in which powerful groups control competition to advance their own interests. Minority groups, having been systematically excluded from power, are therefore disadvantaged in the market. Although competitive market forces may generate pressure for integration, the market does not function independently of political, social, and cultural institutions. Economic activity is embedded in cultural traditions and power relations, and competition is sufficiently imperfect to allow individuals and firms to exercise their prejudices and power without losing profit.

Since the Civil Rights movement of the 1960s, the mechanisms by which unequal power circumscribes and limits the integrating force of market

competition have become more subtle. Discrimination may persist in part because less-successful whites attribute their plight to competition from minority persons rather than the concentrated power of corporations. They also rely on racial pride and identity in an attempt to create a unique sense of community in an increasingly integrated and homogenized society.²¹

The psychological roots of discrimination also extend to minority persons who often reside in neighborhoods characterized by inferior schools, high unemployment, high crime rates, dilapidated housing, and dysfunctional families. Since individuals' self-images are shaped by their social environment, minority persons may come to view themselves as inferior and consequently fail to develop the aspirations needed to escape their plight. Low self-esteem is also perpetuated by a lack of minority persons in prominent social positions who might serve as role models for children. Finally, even those minority persons who maintain self-esteem may be subject to a "feedback effect," causing them to invest less time and money in acquiring productive skills because they perceive that members of their group earn lower financial returns on such investments.

Even when overt racism is absent, discrimination may persist. An employer may be reluctant to hire minority workers for fear that customers and other employees may react negatively to their presence. A homeowner may persuade a neighbor not to sell a house to a minority person based on the belief that housing values decline when a neighborhood is initially integrated. In both cases, discrimination results not from personal animosity toward minority individuals but from assessments of the economic realities of a racist society.

Discrimination in hiring can also persist if employers lack full information about the productivity of job applicants. The employer could conduct extensive interviews and research to determine each applicant's qualifications, but this process would be efficient only if the benefits of hiring more qualified employees exceed the costs of obtaining information. In the absence of full information, employers may rely on prevailing stereotypes about the characteristics of different groups and screen candidates on the basis of race and ethnicity. Economists use the term "statistical discrimination" to describe this reliance on group characteristics to assess individual members of a group.²²

Responses to Discrimination

The Modern Liberal belief that discrimination is embedded in society's institutions means that viable solutions must involve legal and structural changes as well as changes in individual values. Modern Liberals were instrumental in the Civil Rights movement, pushing for legal reforms such as the Civil Rights Act, the Voting Rights Act, the Equal Opportunity Act, and desegregation of schools.

However, equal schooling and equal civil rights cannot fully compensate for the deprived family backgrounds affecting many minority children trapped in a cycle of poverty. As a result, Modern Liberals call for not just equality of opportunity but also greater equality of result. Minority persons cannot take full advantage of the opportunities opened by legal reforms unless their income is sufficient to sustain full human development. The most direct strategy for improving the material well-being of minority groups would be redistribution of income and wealth through taxes and transfers. Although theoretical justification for such a policy has been provided by both Keynes and Rawls, most Modern Liberals oppose large-scale redistribution as politically infeasible and damaging to incentives. Instead, they opt for less ambitious government intervention including raising the minimum wage, providing greater public assistance, and strictly enforcing legal safeguards against discrimination.

In the 1970s, Modern Liberals turned to affirmative action to encourage employers to search vigorously for qualified minority job candidates.²³ They argued that affirmative action was necessary to provide minority children with adult role models in professional and managerial positions. Modern Liberals rejected the Classical Liberal criticism that affirmative action reduces efficiency by placing employees in jobs for which they might be unqualified. Many job skills are acquired after the hiring process, so people become qualified by virtue of being employed. Affirmative action increases the opportunities for minorities to gain access to good jobs. Finally, Modern Liberals made the argument that slavery and discrimination benefitted many generations of whites, so affirmative action would simply counterbalance the injustices of the past.²⁴

In the decades since the 1970s, a "white backlash" of anger and resentment against affirmative action, coupled with several key decisions by

the Supreme Court, caused many Modern Liberals to adopt a new approach to improving opportunities for minority groups. Multiculturalism is intended to develop increased public awareness of minority cultures. Modern Liberals hope that as citizens learn to value and respect a wide variety of cultural practices, the fear and ignorance that fuel discrimination will subside. Multiculturalism also restores pride among minority groups by highlighting their contributions and achievements.

NOTES

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11. See David M. Gordon, Richard C. Edwards, and Michael Reich, *Segmented Work, Divided Workers: The Historical Transformation of Labor in the United States*. New York: Cambridge University Press, 1982.
12. The integrationist perspective is presented in Manning Marable, *Beyond Black and White*. New York: Verso, 1995. The separatist perspective can be found in John T. McCartney, *Black Power Ideologies*. Philadelphia: Temple University Press, 1992.
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14. See J. Angelo Corlett, *Race, Racism and Reparations*. Ithaca, NY: Cornell University Press, 2003; Boris Bittker, *The Case for Black Reparations*, 2nd ed. Boston: Beacon Press, 2003; and Janna Thompson, *Taking Responsibility for the Past: Reparations and Historical Injustice*. London: Polity, 2002.
15. Richard J. Herrnstein and Charles Murray, *The Bell Curve: Intelligence and Class Structure in American Life*. New York: Free Press, 1994; Arthur R. Jensen, *The g Factor: The Science of Mental Ability*. Santa Barbara, CA: Praeger, 1998; See also Hans J. Eysenck, *Intelligence: A New Look*. Piscataway, NJ: Transaction Publishers, 2000; Richard Lynn and Tatu Vanhanen, *IQ and the Wealth of Nations*. Santa Barbara, CA: Praeger, 2002; J. Philippe Rushton, *Race, Evolution, and Behavior: A Life History Perspective*, 2nd ed. Port Huron, MI: Charles Darwin Research Institute, 2000; Nicholas Wade, *A Troublesome Inheritance: Genes, Race, and Human History*. New York: Penguin Press, 2014; Michael Levin, *Why Race Matters: Race Differences and What They Mean*. Oakton, VA: New Century Books, 2005; and Vincent Sarich and Frank Miele, *Race: the Reality of Human Differences*. Boulder, CO: Westview Press, 2004.
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Chapter 12

The Political Economy of Gender

When the study of political economy originated in the 18th century, theorists and writers made few references to women. For example, the U.S. Declaration of Independence states that “all men are created equal.” This omission of the female gender from political economy is certainly outdated in modern industrial societies where women actively participate in the labor force. However, discrimination against females still prevails as many women remain relegated to positions offering lower status and less income. Even after adjusting for differences between males and females in educational background and number of hours worked, women are paid, on average, 78 cents for every dollar earned by men.

Gender discrimination poses additional issues besides those associated with racial or ethnic discrimination. The anatomical and procreative differences between men and women are undeniable, and some theorists claim that women and men are motivated by innately different values and interests. In determining the extent of gender discrimination, economists distinguish between “in-market” discrimination, which involves unequal treatment of equally productive persons, and “pre-market” discrimination, which arises from social institutions, including schools, family structure, and traditional values. Pre-market discrimination may render women less

productive, in which case their lower wages would not reflect in-market discrimination.

Efforts by economists to assess the extent of in-market discrimination are hampered by the porous boundary separating public life and private life. Prevailing stereotypes about women may play a role in hiring decisions, but these same stereotypes also shape child-rearing practices, perceptions of role models, educational programs, and training opportunities. Even women's career choices may reflect their internalization of prevailing stereotypes. Thus in-market and pre-market discrimination reinforce each other, making separate statistical analysis of discrimination in the labor market haphazard at best.

While issues related to gender have traditionally centered around heterosexual men and women, recent decades have witnessed the emergence of growing support for extending equal rights and opportunities to lesbian, gay, bisexual, and transgendered (LGBT) individuals in recognition of different sexual orientations and gender identities. Much of the analysis in this chapter applies to LGBT issues as well as women's issues.

THE CLASSICAL LIBERAL PERSPECTIVE

Explanations of Gender Roles

When 18th-century Classical Liberals spoke of the “rights of man,” they may have been referring only to males because women were largely excluded from public life.¹ However, early U.S. feminists such as Sarah Grimke (1792–1873), Elizabeth Cady Stanton (1815–1902), Lucretia Mott (1793–1880), and Susan B. Anthony (1820–1906) assumed that these rights applied to all humans.² Seeking the same legal rights to choice and self-determination as were held by men, they envisioned a society in which all persons, regardless of gender, would be free to compete in the market for rewards based on productivity.

Today, Classical Liberals anticipate that the abolition of legal and political barriers to advancement will result in justice for both men and women. The market economy, with its freedom of choice and equal opportunity, is the best guarantee that women's efforts and abilities will be fairly rewarded.³ If women and men are equally productive, then employers should prefer to hire women because past discrimination has suppressed female wages. Any employer who continues to discriminate by hiring only men will experience higher wage costs, resulting in lower profit and inability to compete effectively. Competitive market force will eventually establish equal pay for equal work regardless of whether the employee is male or female.

Classical Liberals suggest that even sexist attitudes among male workers cannot prevent the market from eliminating discrimination. If some males resent working alongside women, they will demand higher wages for undergoing the "disutility" of an integrated workplace. However, market competition will not permit an employer to pay higher wages to men without a corresponding loss of profit. Therefore, employers will pressure male workers to accept the presence of females or, failing that, will establish segregated worksites where men and women earn equal wages but work separately. In either case, wage discrimination against women will end.

Classical Liberals rely on the following explanations for the differences between male and female social roles and earnings:

1. *Women's abilities.* While Classical Liberals prefer not to emphasize genetic differences among individuals, they acknowledge that differences in productivity may be at least partially attributable to different abilities and interests between genders. They point to the relative stability of gender roles over the ages as evidence that men and women have different aptitudes and tend to specialize in those roles for which they are best suited. Economist Gary Becker (1930–2014) claimed that if women are better than men at homemaking, then economic efficiency is enhanced when women specialize in domestic labor and trade these services for a share of their husband's earnings.⁴ If men are more productive than women in the labor market, the theory of comparative advantage demonstrates the inefficiency

of husbands and wives sharing household tasks since the husband can better use his time earning a salary outside the home.

Extending Becker's analysis, economists Gordon Tullock (1922–2014) and Richard McKenzie described the family as a “producing unit” that operates like a profit-maximizing firm in establishing the most efficient division of labor.⁵ This analysis applies not only to the structure of the family but also to occupational segregation. Competitive markets will effectively preclude women from performing types of work for which they are less well suited. To the extent that occupational segregation and a gender wage gap reflect differences in abilities between men and women, Classical Liberals claim that no discrimination occurs. However, as technological advancements reduce the value of physical strength, women's relative status in the workplace can be expected to improve. Indeed, women are increasingly filling managerial positions as communication and organizational skills become more important than physical prowess and intimidation in motivating employees.

2. *Women's preferences.* Classical Liberals attribute much of the difference between male and female jobs and wages to the rational choices of self-interested individuals. All persons, they believe, choose social roles in accordance with personal preferences. Classical Liberals note that many women are strongly oriented toward home and family and that this commitment often limits their acquisition of education and training, their choice of occupation, and their mobility. If women choose to marry and raise children rather than obtain educational credentials, job skills, and work experience, then their productivity in the market will be lower.

When women are employed outside the home, their commitments to home and family may cause them to choose jobs such as retail sales or clerical work that permit intermittent employment and require skills that do not depreciate rapidly over time. Such jobs typically offer lower wages and few opportunities for advancement, leaving women with less experience and seniority than their male counterparts. A significant portion of the gender wage gap is attributable to the concentration of women in low-wage occupations. However, Classical Liberals argue that this occupational segregation and the resulting wage gap arise from women's own

preferences. They choose to work in low-paying jobs so that they can spend more time with their families.

3. *Market disequilibrium.* As the number of women entering the labor force has risen in recent years, the market has been unable to quickly absorb all persons seeking work. The excess supply of women crowding into entry-level positions depresses wages for such jobs. Classical Liberals offer several explanations for rising female participation rates in the labor force. Improvements in household technology have reduced the time necessary for housekeeping, thereby freeing women to pursue employment outside the home. Moreover, the tendency for family size to decrease as standards of living rise has further reduced the domestic responsibilities of women. Finally, as women have gained equality in education, their increased earning potential makes working outside the home more attractive.

Classical Liberals remain confident that the concentration of women in low-paid occupations will dissipate as the market adjusts to increased supplies of female labor and steers women toward jobs corresponding to their abilities and preferences. More productive women will be rewarded with higher wages and promotions to better jobs. As evidence that the market is making these adjustments, Classical Liberals note that the gender wage gap is substantially smaller for young women than for older women.

4. *Government intervention.* Classical Liberals argue that efforts by government to protect women from dangerous or dirty work are demeaning because they imply that women are less capable than men. In fact, these policies often reflect efforts by men to preserve their own status. Men can effectively reduce competition for their jobs by securing legislation aimed at restricting women's opportunities, thereby forcing women to crowd into "female occupations" and driving down wages for those jobs. Examples of such policies include laws prohibiting women from lifting heavy objects or working in hazardous conditions. Also, laws requiring equal pay for men and women remove the financial penalty of paying higher wages to hire only men and, therefore, discourage employers from hiring women. In general, Classical Liberals claim that all government restrictions on free markets have distributive effects; some groups are advantaged and other groups are harmed.

Policy Proposals

Classical Liberals propose that discrimination against women can be eliminated by establishing a free market. Public policy should be made “gender-blind” by removing all references to gender in laws and regulations. Classical Liberals supported the ratification of the 19th amendment to the U.S. Constitution in 1920, granting women the right to vote. Three years later, an Equal Rights Amendment (ERA) was proposed in congress, declaring that “men and women shall have equal rights throughout the United States and everyplace subject to its jurisdiction.” Classical Liberals initially supported the ERA, while Modern Liberals feared that it would eliminate laws intended to protect working-class women from dangerous and degrading work. Over time, the two groups reversed their positions. Classical Liberals objected to expanding the power of government to enforce the ERA, and Modern Liberals embraced the ERA while relying on other laws concerning occupational health and safety to protect all workers. The ERA finally gained congressional approval in 1972, but it needed approval by three-fourths of state legislatures before it could become law. In the end, strong opposition by Classical Liberals and Conservatives resulted in the ratification process falling short by three states, and the amendment failed.

While Classical Liberals support the concept of “equal pay for equal work,” they claim that only the market can determine the relative value of different jobs. Any attempts by government to determine what constitutes “equal work” would depend on which criteria are used in the assessment and therefore be arbitrary. For Classical Liberals, the value of any work is determined purely by what an employer is willing to pay. The competitive pressures of the market will ensure that employers pay no more and no less than the value of the productive contribution made by each worker.

Some Classical Liberal economists have proposed policies to extend the logic of the market into the private realm of the family. For example, to control population growth, Classical Liberals have suggested that government establish a market for the right to bear children. Adults would be granted a voucher for the right to produce one child, and then, depending on their preferences and ability to pay, they could buy or sell vouchers to reach their desired family size. Unlike China’s efforts to control population

growth by restricting the number of children in families, the Classical Liberal proposal would allow individuals to choose their family size dependent on ability to pay.

The development of artificial insemination and embryonic transplants has already transformed childbearing into a marketable service as some women contract with hopeful couples to bear children in exchange for money. In the absence of legal obstacles, supply and demand will determine the appropriate price for “renting” the womb of a surrogate mother. Extending this reasoning, Richard Posner has proposed markets for babies so that couples can buy and sell to achieve their desired family size. This policy is consistent with economic efficiency, which dictates that any commodity should be allocated to those who are most willing and able to pay for it.

THE RADICAL PERSPECTIVE

Explanations of Gender Roles

Some early feminists pursued goals beyond mere equal rights, arguing that women would remain oppressed until fundamental changes occurred in major social institutions including the economy, marriage, family, and religion. Perhaps the most radical of the early feminists was Mary Wollstonecraft (1759–1797), who claimed that women were socialized to be servants of men and thereby prevented from achieving full personal development. Mere legal reforms would not be sufficient to liberate women; genuine freedom would be attained only when women and men held equal economic and political power.

Karl Marx and Friedrich Engels claimed that the different social roles played by men and women are conditioned by a society’s economic system. The earliest communal societies were sometimes matriarchal, but as soon as technological progress yielded production of a surplus beyond what was immediately consumed, men instituted private property rights to establish control over the surplus. Along with the emergence of private property came male dominance over women as men exerted power over women’s reproductive activities to assure the transmission of property to legitimate

heirs. Women became the property of men, sometimes to the point of being bought and sold by families and communities.

According to Marx and Engels, the industrialization that accompanied the emergence of capitalism in the 18th and early 19th centuries profoundly affected gender roles. Initially, employers hired any able-bodied man, woman, or child, but the effects on family life were devastating. Long working hours and dangerous conditions in the factories left workers with little time or energy for child rearing, recreation, or personal development. Employers gradually realized that they were undermining the quality of the labor force and so supported legal reforms to limit female and child labor in heavy industry. In effect, employers now obtained two workers for the price of one; the husband toiled for 12–16 hours per day in a factory while his wife labored at home to keep the husband emotionally and physically prepared for labor and to rear the next generation of workers. For men, home and family became havens from the alienating experience of work.⁶

By the 20th century, as advancing technology lightened the burden of housekeeping and employers sought new sources of cheap labor, women re-entered the labor force. This process accelerated during wartime due to the absence of many male workers. Yet the entry of women into the labor force had an unintended consequence. As the number of two-income households increased, competitive market forces replaced a “family wage” with a wage adequate to support only a single person. This erosion of wages undermined the traditional nuclear family as men could no longer earn enough to support their families and women became increasingly capable of financial independence. From the Radical perspective, rising divorce rates, disintegration of families, and the blurring of gender roles are not symptoms of moral decline but rather consequences of capitalism. Markets and money penetrate every sphere of human existence, breaking down bonds and obligations among people and replacing personal relations with a “cash nexus.”⁷

If the struggle for equal rights in the early 20th century can be thought of as the first wave of feminism, a second wave appeared in the 1960s and 1970s in the form of the women’s liberation movement. Many of the leading theorists of second-wave feminism had a Marxist orientation, but others such as Kate Millett and Mary Daly (1928–2010) rejected Marx,

claiming that biology plays a larger role in determining gender roles than does the system of production.⁸ Men, they argued, are violent, aggressive, and domineering by nature and have always attempted to oppress women. Women are made vulnerable to oppression by their childbearing function, which historically made them dependent on men for support. For these non-Marxist Radicals, the major obstacle to women's liberation is not capitalism but rather patriarchy—the dominating power of men over women. They pointed to the former Soviet Union as evidence that ending capitalism and including women in the labor force are insufficient to secure women's liberation.

Other second-wave feminists such as Juliet Mitchell, Zillah Eisenstein, and Nancy Hartsock affirmed many of the insights provided by Marxism while criticizing Marx for being insufficiently critical of patriarchy.⁹ By reducing all oppression in capitalist society to exploitation of workers by capitalists, Marxism fails to offer an analysis of the unique oppression faced by women. To expand Marxian analysis, these Radical theorists treat household production as an integral component of a society's economic system. Women's work in the home is essential to the productivity of men and also plays a major role in instilling the behaviors and ideology essential for the next generation of workers. Radicals claim that the power of patriarchy manifests itself in the form of violence against women, job discrimination, and the subtle conditioning of women's own self-image. The very concept of femininity, they argue, is a "social construction" created largely by men to perpetuate male dominance. Because female identity is defined by men, the social roles available to women in a patriarchal society are inherently oppressive.

Beginning in the early 1990s, a third wave of feminism began to emerge.¹⁰ By this time, the success of second-wave feminism had removed most legal barriers to women, yet the dominance of white males persisted. While second-wave feminists sought to eliminate distinctions between men and women, third-wave feminists defend the freedom of all individuals to choose their gender identity and orientation. They reject traditional stereotypes of masculinity and femininity as artificial social constructs, instead advocating a spectrum of possible genders.¹¹ While second-wave feminism was dominated by white, middle-class women, third-wave

feminists seek to build a broad coalition of groups currently marginalized due to race, gender, class, ethnicity, sexual orientation, or physical ability. They use the term “intersectionality” to describe the linkages between oppression of women and other disadvantaged groups.¹²

Radicals believe that subordinate status of women in capitalist societies creates a powerful impetus for moving beyond capitalism. Women’s frustration with alienating work, coupled with the burden of performing household labor in addition to paid labor, is breeding discontent that will spill over into organized political movements to change the institutional structure of society. In the phrase popularized by second-wave feminists, “Sisterhood is powerful!”

Policy Proposals

Radicals support all efforts to eliminate legal barriers to the advancement of women, but they believe additional measures are necessary to overcome the discrimination created outside labor markets by gender stereotypes and patriarchal power. The following proposals are designed to supplement or in some cases override the market in order to achieve gender equity:

1. *Government funding of social benefits.* Women take on many of the responsibilities for maintaining a healthy, stable society without any financial remuneration. Radicals propose that all citizens should share the financial burden of these responsibilities by establishing publicly funded social benefits such as health care, day care for children, paid leaves of absence for pregnancies and the care of sick children, more public housing, public transportation to schools, and care for the elderly.¹³

2. *Comparable worth.* Laws requiring “equal pay for equal work” fail to address the issue of occupational segregation in which men and women perform different types of jobs. During the 1980s and 1990s, Radicals and Modern Liberals pushed for laws requiring equal pay for work of “comparable worth.” The value of any job would be assessed by using objective criteria such as level of responsibility, physical difficulty, and amount of training required. By assigning points in each category, a numerical rating would be established for each job, and pay would

correspond with that rating. The goal of comparable worth is to formulate an objective measure of the value of different jobs independently of the market's valuation.¹⁴ The rationale for paying women more than their market-determined wage is to acknowledge not only the unfairness of traditional wage structures but also the value of women's productive contributions in the home. Several state governments in the United States adopted comparable worth programs, but private employers have successfully resisted such efforts.

3. *Wages for housework.* Some Radicals have advocated that homemakers be paid wages in recognition of their productive activities performed outside the formal labor market. Many European governments effectively pay wages for housework in the form of "family allowances" dependent on the number of children in the household. In the United States, income tax deductions for dependent children serve as subsidies for child rearing. However, the actual payment of wages for housework has never been adopted because the amount of housework done by homemakers cannot be easily measured. Also, the proposals were never clear about whether the government, the spouse, or the spouse's employer would pay the wages. Not all Radicals supported this idea; some argued that paying wages for housework would represent an extension of market relations into the household.

4. *Women-centered institutions.* During the 1970s, some Radical feminists proposed that the only viable strategy for the liberation of women was to develop separate "women-centered" organizations, communities, and businesses that limit male presence. "Consciousness-raising groups" represented embryonic efforts to build communities free of domination by males. Shulamith Firestone (1945–2012) suggested that artificial insemination offers an unprecedented opportunity for women to escape their biological dependence on men for reproduction and to become autonomous, self-directing persons.¹⁵

5. *Affirmative action.* Both Radicals and Modern Liberals support affirmative action programs to open additional employment opportunities

for women. Radicals are more likely to favor quotas to mandate a specified number of female employees, while Modern Liberals view affirmative action as simply encouraging employers to increase efforts to find qualified female job candidates.

6. *Collective households*. For some Radical feminists, the nuclear family is inherently oppressive to women who desire to work outside the home since they are burdened with the “double duty” of housework and participation in the paid labor force.¹⁶ Radicals also note that capitalism thrives on overstressed nuclear families as increasing amounts of household work are transferred to the market (e.g., paid child care, take-out meals, and laundry services). If the pressure on nuclear families results in divorce, the capitalist economy still benefits as each partner is forced to purchase additional household commodities. To overcome market pressures on nuclear families, some Radicals suggest collective households in which several families live communally in order to share responsibilities and take advantage of economies of scale and modern technology to accomplish tasks such as cleaning, shopping, food preparation, and child care more efficiently.

THE CONSERVATIVE PERSPECTIVE

Explanations of Gender Roles

While sexism is not logically implied by Conservatism, the Conservative emphasis on hierarchy often extends to the roles of men and women. Conservatives explain differences in gender roles by attributing the following characteristics to women:

1. *Compassion*. According to Conservatives, women are “other-oriented.” They derive personal fulfillment through meeting the needs of others. This compassion makes women ideally suited for roles such as mother, homemaker, teacher, and nurse that require ability to care, nurture, and mediate conflict. George Gilder describes the positive effect women have on men. Outside of marriage, he claims, men are “barbarians” who

lack responsibility and purpose in their lives and aimlessly pursue immediate pleasure. Women are able to channel the aggressive and potentially violent nature of men into productive work and parenting.¹⁷

2. *Irrationality*. Sigmund Freud (1856–1939) claimed that women have weak superegos, making them incapable of objective, dispassionate reasoning and, therefore, unfit for positions of responsibility and authority. Freud went so far as to portray women as subversive to civilization because they act on instinct and emotional impulse rather than making rational calculations of consequences. Women’s irrationality is innate and cannot be changed by expanding education or employment opportunities. In Freud’s words, “anatomy is destiny.”¹⁸

3. *Sensitivity*. Conservatives observe that women’s sensitivity to the needs of others makes them well-suited for homemaking and the caring professions. However, this sensitivity has a darker side. Women easily take offense when they perceive that someone else is not caring and considerate. Their feelings are easily hurt. These traits make women unsuitable for higher-status positions that require emotional stability, reliability, and a “thick skin.”¹⁹

4. *Passivity*. Conservatives view women as more passive than men due to differences in hormonal balances. Specifically, lower levels of testosterone in women explain reduced aggressiveness and muscular development. To the extent that certain social roles require strength and forcefulness, women are ill-suited to perform these tasks.

Differences in temperaments and abilities of men and women dictate separate and well-defined gender roles. Just as the human body requires different types of cells to function, society needs differentiated gender roles to remain viable. The sociologist Talcott Parsons (1902–1979) claimed that women are best suited for “expressive” roles, while men have greater aptitude for “instrumental” roles. Social harmony requires that women fill nurturing roles as wives, mothers, and members of the “helping professions” while men engage in physical work and rational analysis.

Conservatives insist that gender differences are naturally complementary. Men need women to raise their children and provide a fulfilling home life, while women need men as sources of authority and financial support. So long as men and women accept one another's relative strengths and weaknesses, harmony will prevail. Indeed, the different capacities of men and women constitute the basis for sexual attraction and are, therefore, essential to human reproduction.

Conservatives are disturbed by the breakdown of traditional gender roles and identities. They place much of the blame on the deterioration of the nuclear family.²⁰ Viewing the family as the basic unit of society and the primary site of socializing the next generation, they reject the Classical Liberal notion that humans develop through rational choice. The family provides adult role models and moral instruction that will shape the choices and behaviors of children for the rest of their lives. Experiencing parental authority teaches children to later accept the authority of teachers, employers, and government. In addition, children's observation of their parents' behavior forms the basis for gender identity. When adult gender roles become vague or ambiguous, Conservatives fear that children will become confused and thwarted in developing their own personalities.

Conservatives attribute both growing immorality and a weak economy to the blurring of gender roles and deterioration of the nuclear family. The underlying causes of these trends are found in the following factors:

1. *Government.* When government intrudes into the everyday existence of citizens, traditional authority figures in the family, church, and community become less significant in people's lives. For example, the standardization of public-school curricula undermines the influence of parents and local authorities in determining the content of education. Mandatory sex education in schools diminishes parental discretion over child rearing. Welfare benefits and other publicly funded social services reduce women's dependence on men for financial support, thereby undermining male authority within the family. Finally, Conservatives blame government for a weak economy, which undermines men's abilities to support their families and forces women to enter the labor force.

2. *The market.* Although Conservatives long ago accepted the market as a lesser evil than government control of the economy, their suspicions about the corrupting and disintegrating effects of competitive market forces have resurfaced in their analysis of the family. From the Conservative perspective, the family and the market operate on diametrically opposed principles. The market fosters the individual pursuit of material self-interest, while the family depends on cooperation, sacrifice, and a sense of collective purpose and identity. The family should offer a haven of security and commitment in an otherwise fragmented, competitive, and individualistic society. The experience of growing up in families with strong parental authority teaches children to place their duties above the pursuit of self-interest.

However, the market has become the dominant institution in modern societies, and its principles have penetrated and, in many cases, overwhelmed the virtues of family life. Once the market mentality pervades the home, calculations of self-interest displace the commitment and caring essential to maintaining a stable family. The father's authority is challenged as women and children adopt the autonomous and self-interested behavior previously reserved for men in the market. In short, families cannot function as cohesive social units if all members are purely self-interested.²¹

High divorce rates, single-parent households, teen substance abuse, and juvenile delinquency provide testimony to the deterioration of commitment and obligation in the family. From the Conservative perspective, the Classical Liberal portrayal of marriage and child rearing as self-interested exchanges and implicit contracts between autonomous individuals is descriptive of the problems confronting modern families. In the absence of traditional gender roles, individuals become calculators of self-interest in even the most personal aspects of their lives. Without the influence of cohesive, stable families, society will eventually degenerate into a chaotic struggle among individuals unable and unwilling to control their selfish impulses.

3. *Feminism.* Both government and the market have contributed to the rise of feminism by undermining the ability of men to financially support their families and by offering women alternative sources of financial

support. Conservatives view feminism as symptomatic of the general trend toward narcissism and selfishness in modern societies.²² Feminists are accused of shirking their duties as mothers and wives as they pursue “self-fulfillment” and seek to “find themselves.” For Conservatives, the basic error underlying feminism is a failure to perceive that personal fulfillment for women comes from the commitments and responsibilities accompanying family life. What feminists call “liberation” is actually selfishness, and a society of selfish individuals is unsustainable.

Conservatives also claim that feminism damages men by undermining their identities as providers, protectors, and authority figures within the family. Faced with the challenge of feminism, men lose self-esteem and become confused about their purpose in life. George Gilder argues that men’s economic productivity has been adversely affected by feminism because when women are actively involved in the labor force, men no longer feel as compelled to work.²³ Male earnings are no longer necessary to support a household, and working women undermine men’s attachment to work as a uniquely male source of self-esteem. To the extent that feminism contributes to divorce, men are freed from most of their domestic responsibilities, causing further deterioration in their identities as providers.

Conservative women such as Phyllis Schlafly and Anita Bryant claim that feminists demean women who choose the roles of housewife and mother.²⁴ Women in traditional roles are made to feel inadequate in comparison with women who pursue careers. The resulting confusion and loss of confidence contribute to the blurring of gender roles as women feel compelled to prove their worth outside the home. Conservatives claim to be the true defenders of women’s rights by attempting to preserve the status and privileges attached to traditional female roles.

Policy Proposals

Because they blame both government and the market for undermining gender roles and threatening the family, Conservatives cannot rely exclusively on either institution to solve the problem. On one hand, they believe that less government intervention would revitalize the economy, enabling men to find jobs and support their families. Yet, Conservatives propose a variety of government policies and regulations to promote

“traditional family values.” They reject the Classical Liberal view of government as a neutral referee and call on political leaders to consciously defend and promote traditional gender roles and family values.

Market pressures to integrate and homogenize the labor force can be reduced through legislation to place restrictions on female employment in jobs requiring strenuous labor or excessive risk. The tax code could be revised to give larger deductions to families with only one employed spouse. To preserve the nuclear family, Conservatives propose to make divorce more difficult and to reduce welfare benefits to single-parent households. Conservatives have consistently opposed the ERA, claiming that it would further erode differences in gender roles and would abolish the legal requirement that men provide financial support to their wives. The ERA, they claim, would actually result in men’s liberation from family responsibilities.

High on the Conservative agenda is overturning the 1973 Supreme Court decision in *Roe v. Wade* legalizing abortion in the United States. For Conservatives, the issue of abortion encompasses much more than simply safeguarding fetuses in the womb. They view “a women’s right to choose” as symptomatic of the narcissistic individualism pervading modern societies. Pregnant women and their husbands have a moral obligation to protect the fetus that overrides any calculations of costs and benefits attached to a birth. Conservatives argue that when women have complete control over reproduction, male authority is undermined and families disintegrate. Opposing abortion became a central focus of Conservatism only after the women’s liberation movement of the 1960s threatened male dominance and traditional female roles.

Another lightning rod for Conservative protest is same-sex marriage and the broader issue of equal rights for the LGBT population. Many Conservatives view homosexuality as a lifestyle choice by individuals who have become confused by the blurring of gender roles and the decline of morality in modern societies. By legalizing same-sex marriage, Conservatives argue that governments are legitimizing homosexuality, thereby creating further moral confusion for young people in forming their gender identities and orientation.

Finally, some Conservatives advocate censorship of or at least restricted access to pornography and other material deemed to appeal to “prurient

interests.” In the case of school textbooks, Conservatives have opposed the adoption of curricular materials portraying women in nontraditional social roles or promoting acceptance of homosexuality. Conservatives remain pessimistic about the future of gender roles and the family. The economy’s increasing inability to provide a “family wage” for male workers contributes to the breakdown of the family, and, reciprocally, the breakdown of the family undermines the economy by producing self-centered, poorly socialized children ill-equipped to work effectively and to handle the responsibilities of adult life. Due to this circular path of causation, any effective Conservative strategy must simultaneously deal with misguided government policies, powerful market forces, and the influence of feminism.

THE MODERN LIBERAL PERSPECTIVE

Explanations of Gender Roles

Not all early feminists were in favor of equal rights for women. Both Margaret Fuller (1810–1850) and Charlotte Perkins Gilman (1860–1935) claimed that women are innately less aggressive and individualistic than men. These feminine traits promote nonviolence, cooperation, and civic virtue and are, therefore, essential to a well-balanced society. Because of their innate differences, women and men occupy “separate spheres”; women need protection from the government to assure that competitive market forces will not subject them to the same hardship and exploitation experienced by male workers. Early Modern Liberal feminists supported legal restrictions on women’s working hours and on women’s entry into occupations such as mining or operating heavy machinery. The Modern Liberal rejection of equal rights for women is illustrated by the fact that Eleanor Roosevelt (1884–1962), the National Women’s Trade Union League, and the League of Women Voters opposed the ERA when it was first proposed in 1923, fearing that it would abolish all legislative protection for women.

Modern Liberals eventually decided to support the ERA, and by the 1960s, they joined with Radicals to establish the women's liberation movement. Writers such as Betty Friedan (1921–2006), whose 1963 book *The Feminine Mystique* is widely regarded as the beginning of second-wave feminism, and Gloria Steinem, founder of *Ms.* magazine, challenged stereotypical social roles for women as mothers, homemakers, and subordinates in the workplace.²⁵ With the founding of the National Organization for Women (NOW) in 1966, Modern Liberal and Radical feminists formed a powerful political movement that would change not only laws but also attitudes about women's roles.

Unlike their Radical counterparts, Modern Liberal feminists believe that women can obtain equal rights within capitalism. They attribute discrimination to ignorance and gender stereotypes, concluding that employers should welcome equal rights for women since sexism effectively denies half the population a full opportunity to contribute to economic activity. To prevent unenlightened employers from continuing to discriminate, Modern Liberals advocate laws and regulations banning discrimination and promoting equal opportunity.

Modern Liberals continue to debate whether to acknowledge innate differences between men and women that might be used as the basis for stereotypes and discrimination. Psychologist Carol Gilligan claims that women view the social world as one of relationships, commitments, and responsibilities, whereas men view society as composed of separate individuals whose interaction is based on rules and rights.²⁶ If women adopt the competitive individualism of men in their quest for job success, they risk compromising their feminine qualities. Gilligan does not propose that women should remain at home, but suggests that institutional changes such as flexible work hours and increased reliance on teamwork are necessary to accommodate the different needs and interests of women in the workplace.

Similarly, Nancy Chodorow claims that differences in male and female gender identity are determined at a very early stage of childhood development.²⁷ Boys develop more "rigid ego boundaries" because they must differentiate themselves from their mothers. In the process, they form identities as separate individuals in competition with others. Girls, in contrast, share the gender of their mother and, therefore, develop a more

fluid sense of self that emphasizes interpersonal connections and sympathy with the needs of others. These gender differences prepare girls for the role of mother, while boys, with their sense of separateness and independence, are prepared to participate in the impersonal world of work and business. Chodorow denies that gender differences are purely biological. If men were to become more involved in the early stages of child rearing, traditional distinctions between the psychosocial development of boys and girls might fade. For the time being, however, the differences between adult gender roles are likely to be reproduced in children, and feminists should acknowledge these differences when proposing public policies related to gender issues.

While Modern Liberals acknowledge that competitive market forces create pressures to ingrate women into the labor force, they challenge the Classical Liberal portrayal of the market as an adequate deterrent to discrimination. Discrimination persists despite competitive market forces for the following reasons:

1. *Social conditioning of preferences.* Modern Liberals emphasize the powerful forces of parental, peer, and societal influences affecting young women's aspirations and achievements. This socialization process is institutionalized in such practices as educational "tracking" that steers girls toward coursework that prepares them for traditional female roles. Even more pervasive is the perception of particular occupations as "men's work" and the corresponding stigma attached to women who aspire to those occupations. The choices of young women are also affected by "demonstration effects," whereby the occupational segregation of adult women in lower-status jobs creates an absence of role models for young women with higher aspirations. Similarly, a "feedback effect" operates when young women choose to pursue less higher education because they observe that the financial rate of return to education is less for women than for men. Even women who attain professional positions may be deterred from further success by their isolation and visibility as challengers of traditional gender roles.

2. *Imperfect competition.* The presence of large corporations, labor unions, and various government regulations limits competition and allows

discrimination to continue. For example, some firms may rely on an “old boys’ network” in hiring new employees. Information about job openings may not be widely publicized and job qualifications may include unnecessary education or experience that effectively screens out many female applicants. Classical Liberals insist that such practices cannot survive because competition forces firms to base their hiring decisions solely on productivity of the applicant. However, Modern Liberals believe that competition is sufficiently loose to permit discrimination and stereotypes to persist. The same self-interested motivation underlying market behavior also leads men to construct formal and informal barriers to female competition. Men have a self-interested motive to keep half the population from competing directly with them for jobs and promotions.

3. *Domestic responsibilities.* The division of labor within the family often leaves women with the majority of child-rearing and household management responsibilities. Their occupational choices are limited by these duties. Because so many women face the same predicament of attempting to balance family responsibilities and careers, they tend to enter occupations offering flexible or part-time hours, ease of exit and reentry, and durable skills. This “occupational crowding” results in increased supplies of female labor in certain occupations and, therefore, lower wages and fewer opportunities for career advancement. The occupational segregation of women does not necessarily reflect lower productivity or the individual preferences of women, but rather results from social traditions placing the burden of homemaking primarily on women.²⁸

4. *Sexist attitudes.* Recall the Classical Liberal argument that discrimination cannot persist in the market because even if most employers harbored sexist attitudes, at least one “renegade” employer would break ranks and hire women to take advantage of their lower wages. With lower labor costs, this renegade employer would earn higher profits, be able to grow more rapidly, and theoretically force the sexist employers either to go out of business or to change their attitudes toward women. Modern Liberals question this analysis, pointing to the psychological impact of societal norms in restraining profit-maximizing behavior. The employer who

violates these societal norms by hiring women to perform “men’s work” may be ostracized within the community or may feel guilt for exploiting women in order to earn higher profit. An employer may have a sense of moral responsibility to protect the dignity and virtue of women by shielding them from the rigors of hard work. Alternatively, employers may be reluctant to hire female workers due to concern about the morale of male workers. Employers may worry that the presence of women would distract men, disrupt their camaraderie, and create tensions between coworkers. Male employees engaged in strenuous or risky jobs are more likely to resent female coworkers because the difficulty of their jobs is a source of masculine pride. Employers must be sensitive to these reactions since time and money have been invested in training male workers. Hiring female workers will be inefficient if doing so lowers the productivity of male workers.

5. *Statistical discrimination.* Even employers committed to hiring the best candidate for a job may lack information about the potential productivity of individual candidates. Without this information, employers may rely on stereotypes of women as a group. For example, if women as a group are more likely to drop out of the labor force due to marriage or pregnancy, an employer may reject an individual female applicant simply because she might leave the job. Some highly qualified women who had no intention of leaving the labor force may be bypassed, but if the costs of gathering complete information about candidates exceed the benefits of hiring the most productive workers, then this “statistical discrimination” is efficient from the employer’s viewpoint and will endure even in a competitive market.²⁹

In summary, Modern Liberals claim that nonmarket forces and imperfect competition in the market are sufficient to weaken competitive pressures to end sex discrimination. Even when women’s lower wages do reflect lower productivity or less permanent attachment to the labor force, Modern Liberals argue that these characteristics are themselves conditioned by traditional social values and institutional structures. Women’s choices are made within the context of limited opportunities and incentives. Whereas Classical Liberals attribute lower female wages to lower productivity,

Modern Liberals reverse the causal sequence and view lower productivity as a consequence of low wages resulting from both individual and institutional discrimination against women.

Policy Proposals

The initial mission of Modern Liberal groups such as the NOW was to make all laws gender neutral, and they achieved remarkable success in accomplishing that goal. Although ratification of the ERA failed, Modern Liberals continue to support that effort.³⁰ However, the concern that removing all references to gender in laws might fail to protect women was realized in 1976 when the Supreme Court ruled that a proposed law requiring employers to grant paid leaves of absence to pregnant women was discriminatory because it treated women differently than men.

To move beyond formal equality under the law, Modern Liberals join with Radicals in supporting affirmative action and comparable worth. Modern Liberals make the argument that paying women more than their market-determined wage could actually increase economic efficiency because women's unpaid household labor creates positive externalities. In other words, the social benefits of good parenting exceed the private benefits to the family. Children from nurturing families are more likely as adults to work productively, vote intelligently, and contribute to the good society. Economic theory demonstrates that when an activity generates positive externalities, the market operates inefficiently by allocating too few resources to that activity. To correct the market failure and subsidize women for the positive externalities they create, wages for women should be set above the market-determined level.³¹ A similar argument could be made to support higher wages for those men actively engaged in child rearing.

The issue of violence against women has become a major concern of both Modern Liberals and Radicals. Despite the legal reforms of the past half century, women still own fewer economic resources and have more restricted opportunities for financial success. Coupled with childbearing responsibilities, these disadvantages make many women dependent on men and, therefore, vulnerable to male aggression and dominance. Violence against women is exacerbated by the frustration experienced by males due to alienating work and low wages. The home becomes the only place where

males can assert their dominance and maintain a sense of control and power over their environment.³² To protect women, Modern Liberals support stronger laws and increased prosecution against perpetrators of domestic abuse as well as campaigns to raise awareness of the issue for both men and women.

Modern Liberals support marital property reform so that each partner has a legal right to half of any property acquired during a marriage, even if only one spouse participated in the paid labor force. They would reform social security and unemployment compensation so that unpaid work outside the labor market would entitle a person to the same protections and benefits enjoyed by employed workers. Like Radicals, Modern Liberals support increased government provision or subsidization of health care, day care, and care for the elderly. Finally, Modern Liberals favor more flexible work schedules, paid leaves of absence for parenting, fringe benefits for part-time work, and the option of job sharing between two or more persons.

NOTES

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3. Classical Liberal feminism is presented in Susan L. Brown, *The Politics of Individualism: Liberalism, Liberal Feminism, and Anarchism*, 2nd ed. Tonawanda, NY: Black Rose, 2002; Christina Hoff Sommers, *Freedom Feminism: Its Surprising History and Why It Matters Today*. Washington, DC: AEI Press, 2013; Joan Kennedy Taylor, *Women's Issues: Feminism, Classical Liberalism, and the Future*. Stanford, CA: Hoover Institution, 1993; and Michael Levin, *Feminism and Freedom*, 2nd ed. New Brunswick, NJ: Transaction Books, 1987.

4. Gary Becker, *A Treatise on the Family*, enlarged edition. Cambridge, MA: Harvard University Press, 1993.

5. Richard B. McKenzie and Gordon Tullock, *The Best of the New World of Economics*, 5th ed. Homewood, IL: Richard D. Irwin, 1989; and see also Gary S. Becker and Guity Nashat Becker, *The Economics of Life*. New York: McGraw-Hill, 1997.

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9. Juliet Mitchell, *Woman's Estate*. Baltimore, MD: Penguin, 1975; Zillah Eisenstein, *The Color of Gender: Reimagining Democracy*. Berkeley, CA: University of California Press, 1994; and Nancy Hartsock, *Money, Sex and Power: Toward A Feminist Historical Materialism*. New York: Longman, 1983; Batya Weinbaum, *The Curious Courtship of Women's Liberation and Socialism*. Boston: South End Press, 1999; and Lise Vogel, *Woman Questions: Essays for a Materialist Feminism*. New York: Routledge, 1995.

10. See Stacy Gillis, Gillian Howie, and Rebecca Munford, eds., *Third Wave Feminism*, 2nd ed. New York: Palgrave Macmillan, 2007; Shelley Budgeon, *Third-Wave Feminism and the Politics of Gender in Late Modernity*. New York: Palgrave Macmillan, 2011; and Astrid Henry, *Not My Mother's Sister: Generational Conflict and Third-Wave Feminism*. Bloomington, IN: Indiana University Press, 2004.

11. See Judith Butler, *Undoing Gender*. New York: Routledge, 2004; and Judith Butler, *Gender Trouble: Feminism and the Submersion of Identity*. New York: Routledge, 1990.

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Chapter 13

Education and Culture

Culture encompasses the values, beliefs, and customs that guide human behavior. Education plays an important role in transmitting culture from one generation to the next. Although education and culture have traditionally been the province of sociology and anthropology, their influence on the economy and the political process places them within the scope of political economy. While economists treat choices as arising from the preferences of autonomous individuals, political economists recognize the role of education and culture in forming those preferences. In other words, the broader perspective offered by political economy permits analysis of the role of education and culture in shaping the individual and collective choices determining the structure of society's political and economic institutions. In this chapter, we shall contrast the viewpoints of each of the four ideological perspectives on education and culture.

THE CLASSICAL LIBERAL PERSPECTIVE

The Purpose of Education

Despite their commitment to laissez-faire and free choice by individuals, Classical Liberals claim that children should be subjected to the authority and wisdom of parents and teachers. Thus education should function as an enclave of authority in a society otherwise committed to individual autonomy and choice. Classical Liberals favor not only compulsory education but also compulsory taxation to fund education. The explanation for this willingness to violate their usual defense of individual liberty lies in 19th-century history. As industrial workers became more militant in demanding voting rights, Classical Liberals feared political turmoil unless all citizens were taught to respect society's basic values and institutions. In addition, as production processes became more complex, employers needed a labor force with at least moderate levels of literacy and communication skills. Classical Liberals decided that publicly-funded schools with compulsory attendance provided the best solution to the problems raised by democracy and industrialization.

Several other rationales for compulsory public education have been offered by Classical Liberals. First, whereas most goods in a market economy are allocated on the basis of individuals' ability to pay, education is sufficiently important to society as a whole that every child should have access despite inadequate family income. Second, if education were private and noncompulsory, some parents might not encourage education for their children since the parents would bear the financial burden of paying tuition but would not receive the financial benefits of the child's future income. Third, to the extent that education increases the productivity of the labor force and increases income, it generates additional future tax revenue for governments and, therefore, at least partially pays for itself. In other words, money spent on public education is an investment in "human capital" that will yield financial returns in the future for both individuals and governments. Finally, schools can improve the efficiency of the economy by sorting and matching students with the types of training and employment for which they are best suited.¹

Public education is also attractive to Classical Liberals for political and ideological reasons. The highly unequal distributions of income and wealth generated by free markets conflict with the Classical Liberal ideal of equal opportunity for all individuals to compete in the market. Classical Liberals

view public education as the least intrusive method by which government can attempt to reconcile equal opportunity with unequal income and wealth. To the extent that public schools provide the same education to all children, they promote equality of opportunity without any significant redistribution of wealth or interference with labor markets. The Classical Liberal goal is a meritocratic society in which individual status and income are determined by the productivity of each person's resources rather than by race, ethnicity, gender, or religion.

Educational Policy

Despite their advocacy of public funding for education, Classical Liberals claim that a government monopoly on the provision of education results in high costs, low quality, and indifference by teachers and administrators toward the concerns of students and parents.² Public school teachers and administrators know that their salaries are not directly affected by the quality of education they offer or by the number of their students. Conversely, if a student fails or drops out, public schools rarely penalize the teachers. In short, a lack of accountability means that teachers and administrators have little incentive to provide high-quality education. Public schools become mere youth repositories where unmotivated teachers stand guard over bored pupils.

Classical Liberals are also critical of the content of public education curricula. They claim that governments typically rely on bureaucracies to formulate a standardized curriculum, but this centralized process limits the discretion of local school officials, teachers, and parents. The result is both a lack of innovation and insensitivity to local cultures and values. Classical Liberals believe that a bureaucrat in Washington should not determine what children are taught in school.

To address these concerns, Classical Liberals propose a voucher system in which government would issue to parents a voucher redeemable for education at any public or private school.³ This proposal eliminates government's monopoly on the provision of education while retaining public financing. Schools would compete with one another for students, and those schools with higher enrollments would receive more government funding. The best teachers would presumably move to successful schools

because, by attracting more students and redeeming more vouchers, these schools can offer higher salaries. Conversely, families would shun schools offering inferior education, and teachers' salaries at those schools would fall accordingly. To ensure maintenance of education standards, vouchers would be redeemable only at accredited schools.

By removing the financial barrier to attending private schools, the voucher system would permit families of all income levels to choose schools providing an education best suited to their children's needs. Vouchers would eliminate the penalty currently imposed on parents who choose private education for their children and are forced to pay twice—once for taxes to fund public schools and again for tuition at a private school. If public schools face a large-scale exodus of students, then administrators and teachers would presumably reassess their methods and offer more effective instruction. Those schools unable to improve would gradually disappear as their best teachers would be hired by successful schools and ineffective teachers would be forced to seek employment in other occupations. To summarize, a voucher system would promote accountability, freedom of choice, and improved learning for students by bringing the competitive forces of the market into a previously monopolized system.

Classical Liberals also advocate merit pay for teachers. By linking salaries with teaching effectiveness, Classical Liberals hope to make teachers accountable for the performance of their students and to attract and retain the most skilled teachers. To enable students to afford higher education, Classical Liberals propose educational loans at market rates of interest. They are concerned that direct financial aid to students may distort the market and result in too many students pursuing higher levels of education. Economic efficiency dictates that students should pursue additional education only if the present value of additional lifetime earnings exceeds the opportunity cost of education in terms of tuition, related expenses, and the value of foregone income and leisure. Individual students and their parents are the best judges of whether additional education will result in a sufficient increase in lifetime earnings to justify its cost.

A Classical Liberal curriculum would be organized around the skills and knowledge essential to good citizenship and productive employment. Because Classical Liberals reject the medieval notion of knowledge as

consisting of eternal truths, they demand that education be practical and useful. The natural sciences, history, mathematics, and communication skills should have priority, with less emphasis placed on literature and the arts. Horace Mann (1796–1859), who led the effort to reform U.S. education along Classical Liberal lines, envisioned a common curriculum for all students that emphasized practical knowledge and citizenship skills.

The Role of Culture

Classical Liberals deny the existence of any objective norms by which culture can be judged as good or bad. Individuals should be free to pursue their interests and express themselves so long as they do not harm others. Any cultural forms arising from individuals pursuing their interests are equally valid. Individuals have different tastes, so what is vulgar to one person may be sublime to another, but in a free society, all forms of cultural expression should be tolerated as long as they impose no harm on others.

The difficulty posed by the Classical Liberal position lies with the definition of “harm.” While merely offending another person’s values or tastes is usually not considered harmful, such “victimless” practices as drug abuse, prostitution, and sale of pornography raise the question of whether harm occurs indirectly in the form of highway fatalities, increases in sexual assaults, and exploitation of powerless individuals. To the extent that Classical Liberals acknowledge this indirect harm, they may support laws prohibiting such practices. However, they are predisposed to “live and let live,” assuming that individuals are sufficiently rational to judge the benefits or harm of any particular activity. For example, economist Milton Friedman and former Secretary of State George Shultz supported the legalization of all recreational drugs. They claimed that by restricting supply, prohibition drives up prices and creates huge profits that attract organized crime and contribute to random violence affecting innocent citizens.

Classical Liberals express little concern about the effects of culture on individuals. This indifference stems from their view of the individual as an autonomous entity whose preferences are internally generated and, therefore, independent of the social environment. As rational actors, individuals gravitate toward those cultural forms meeting their preferences

and shun cultural expressions perceived as irrelevant or detrimental. In short, each person is the best judge of his or her own interests and, therefore, should be free to choose any form of cultural expression.

THE RADICAL PERSPECTIVE

The Purpose of Education

Radicals believe that capitalism generates conflict between the owning class and the working class. This conflict poses a continual threat to the cooperation and consensus required for maintaining a stable society. For example, the development of capitalism in mid-19th-century England resulted in frequent riots, strikes, protests, and property damage. The ruling class could have relied on the police and military to maintain order, but that would have been costly and likely to fuel additional anger and resentment. Instead, the ruling class sought to mask and defuse the tensions emanating from class conflict by developing social institutions to promote harmony. Public schools, according to Radicals, serve to maintain and legitimize the dominance of the capitalist class by offering the appearance of equal opportunity.

Although schools would seem to provide children with equal opportunities to develop and display their abilities, Radicals argue that schools in capitalist societies actually perpetuate hierarchy and inequality by shaping students' personalities and consciousness in a manner that facilitates social control by one class over another. Economists Samuel Bowles and Herbert Gintis challenge the Classical Liberal view of education as providing talented and hardworking individuals with opportunities to succeed regardless of their class background.⁴ Bowles and Gintis rely on empirical research to argue that class background is the primary determinant of individual success and that schools function to transmit the class status of families from one generation to the next. Despite a significant trend toward equalization in years of schooling across social classes, the distribution of income has become more unequal.

Bowles and Gintis claim that the hierarchical class structure of capitalism is transmitted from one generation to the next by offering

different forms of education to children of different class backgrounds. The children of workers are trained to follow rules and to accept authority. Schools in more affluent neighborhoods stress creativity, independence, achievement, and leadership skills. This dual educational system is feasible because the residential segregation of families according to income results in largely class-segregated schools. Moreover, the fact that schools are financed by property taxes assures that schools in more affluent districts can offer higher quality education. Even when children from different social classes attend the same school, a system of “tracking” may be used to segregate students according to demonstrated ability, which, in turn, tends to be linked to family socio-economic status.

Even parents are complicit in this dual education system. More affluent parents have learned from their own work experience that leadership skills and innovative thinking are rewarded, whereas working-class parents know that their jobs often require perseverance at routine tasks and submission to the authority of management. Parents typically want schools to instill in their children those personality traits that the parents have found to be essential to success in their own lives.

Besides its role in legitimizing and reproducing class status, education functions to sustain capitalism in other ways. According to Radicals, employers have shaped public education through their demands that children be schooled both in the basic skills required for productive labor and in an ideology supportive of capitalism. Also, public education places much of the expense of job training on taxpayers, thereby reducing costs for businesses. Employers want to minimize on-the-job training because workers are free to take their newly acquired skills and move to other firms.

Despite education’s role in supporting capitalism, Radicals also note education’s potential to disrupt the status quo. While capitalism requires a skilled but submissive labor force, it also promotes the freedom of autonomous individuals to seek mutually beneficial transactions. The presence of both authoritarian and egalitarian social relations in capitalist society places conflicting demands on education to perform both a liberating/developmental function and a repressive/integrative function. Children are taught obedience and conformity in preparation for their roles as workers, but they also learn a sense of fair play and respect for the rights of others in preparation for engaging in market transactions. Radicals

believe that education ultimately creates challenges to capitalism by introducing students to ethical ideals and forms of human interaction inconsistent with the hierarchy and domination inherent in capitalist production.⁵

Educational Policy

Radicals acknowledge that the functional role of education in reproducing capitalism narrows the range of feasible reforms. In the 1960s and 1970s, when Radicals were more optimistic about transcending capitalism, they proposed a variety of models for educating young people to develop their full range of capabilities. “Free schools” permitted students to pursue their own interests, to learn at their own pace, and to integrate their formal knowledge with practical aspects of their lives.⁶ Free schools placed little emphasis on grades, rote memorization, or rule following. Ivan Illich (1926–2002) proposed “deschooling society” by challenging the authority of educators, bureaucrats, and administrators in order to allow both children and adults to learn to think and act independently. Illich suggested that children should work at least two hours each day—whether in factories, offices, laboratories, or farms—so they could learn life skills through hands-on experience. Education should not be confined to a classroom with a single teacher, but rather should occur within the entire community as an ongoing process for children and adults alike.⁷ However, experiments with “free schools” were generally disappointing and led to a backlash even among Radicals.⁸ Students attending free schools were often poorly equipped for the discipline, punctuality, and perseverance required for most jobs in a capitalist economy.

Surprisingly, some Radicals join with Classical Liberals in supporting education vouchers.⁹ In fact, the campaign for school choice has historical roots in the Black Power movement and alternative schools of the late 1960s. Radicals claim that if children from low-income families received larger vouchers and financial support for transportation, their ability to choose among schools would force public schools to upgrade the quality of education and give parents and local communities greater control over the content of education. If parents chose to keep their children in neighborhood schools, the larger vouchers would bring in additional

funding to improve the quality of those schools. In short, educational vouchers would open opportunities to children from low-income families and promote cultural diversity by ending the class segregation of schools.

Unlike Classical Liberals, Radicals would not extend publicly-funded school choice to include private schools. Radicals contend that public schools are essential to providing equal educational opportunities for all students.¹⁰ They attribute the current low quality of some public schools to lack of funding and segregation by social class. The quality of public schools could be upgraded by promoting cultural diversity and gender equity in the classroom, by funding day care and preschool programs to provide children from deprived backgrounds with more equal opportunity, and by giving parents and local communities greater control over the curriculum.

The Role of Culture

Much of the Radical analysis of culture is based on the work of a group of German theorists known collectively as the Frankfurt School. The leading members of this group included Max Horkheimer (1895–1973), Theodor Adorno (1903–1969), and Walter Benjamin (1892–1940).¹¹ Radicals view culture as serving a contradictory role in reproducing capitalism. On one hand, culture perpetuates the hierarchical status quo by offering shared traditions and values that reduce social conflict. However, culture can also be liberating in the sense of creating disruptive challenges to authority and opening people to experiences beyond the realm of capitalist production and consumption of commodities.

As a functional component of capitalism, culture encourages the pursuit of interests through consumption of commodities and popular entertainment. Radicals claim that the banal and insipid quality of much of television, film, and music pacifies citizens and distracts their attention from personal frustrations with work or economic hardship. Culture is largely under corporate control and, like other commodities, is marketed through advertising. Corporate dominance prevents culture from serving its legitimate purpose of authentically expressing the emotions and ideas emanating from the personal lives of citizens.

However, culture is not the sole province of corporations and may also express working-class interests and aspirations. Television may be the modern “opiate of the masses,” but writers and producers need high viewer ratings and, therefore, will cater to working-class interests, as demonstrated by the frequent portrayal of bosses as either tyrants or buffoons. A variety of popular films have sympathetically portrayed union organizers, factory workers, secretaries, or students as victims of incompetent or malevolent authority figures.

The capitalist class may accept subversive forms of culture that allow workers to vent their frustrations in theaters or living rooms rather than at the workplace or the voting booth. Herbert Marcuse (1898–1979) claimed that capitalist society’s tolerance for nearly all forms of cultural expression is actually a form of repression because the apparent freedom to choose among cultural forms disguises the lack of freedom experienced by most citizens in their jobs and in the political process.¹² However, capitalism’s ability to absorb and divert the anger and frustration of workers through culture is not without limits. Subversive culture can eventually jeopardize the stability of capitalist society. For example, popular songs calling for revolution and the murder of policemen are sold by the corporate giants of the entertainment industry. This practice confirms Lenin’s claim that capitalists will sell the rope with which they are to be hanged.

If capitalist culture pacifies and distracts citizens from pursuing their real interests in liberation, then why is it so popular? Radicals explain this apparent paradox by appealing to Marx’s concept of alienation. Alienated individuals do not expect to express themselves through culture; they simply purchase art, music, and games manufactured by the entertainment industry. Culture is “reified”; it appears to exist independently of citizens who do not conceive of themselves as producers of culture but only as consumers who choose whether to buy a particular commercial product. Through a process of “commodification,” culture is reduced to marketable objects sold at a profit. Radicals explain the popularity of “reality TV” and programs featuring amateur singers and dancers as an attempt to overcome reification through the illusion that viewers are themselves creators of and participants in culture.

Radicals attribute the passive acceptance of reified culture to “false consciousness.” In the absence of genuine community and meaningful work, full personal development is thwarted. Instead, many individuals opt for a life of instant gratification through consumption and entertainment. Having adopted this orientation, they view traditional social structures such as family and community as obstacles to the free pursuit of pleasure, resulting in further disintegration of social bonds. This distorted form of human existence fits the Classical Liberal portrayal of humans as autonomous, pleasure-seeking creatures. Radicals, however, claim that such behavior is not intrinsic to human nature but is instead a response to the isolation and alienation fostered by capitalism.

The Radical critique extends to several other aspects of capitalist culture. Radicals attribute mass conformity to attempts by alienated individuals to gain a sense of belonging and solidarity with fellow citizens. At the same time, capitalist culture is characterized by incessant novelty as producers compete to cultivate and profit from new styles and fashions. Advertisers persuade consumers that current consumption patterns are outmoded and that buying newer or updated commodities will bring happiness. In such a world, the very notion of a stable personal identity is undermined as continuity and authenticity slip from memory. Once-meaningful traditions are reduced to mere occasions for purchasing additional goods. On this point, Radicals agree with Conservatives: a focus on consumptive pleasure makes satisfaction elusive. In the narcissistic pursuit of pleasure, individuals neglect social bonds and traditions essential to genuine fulfillment. Moreover, pleasure-seeking individuals will resent the demands for perseverance at routine tasks and delayed gratification placed on them by bosses and other authority figures. Capitalism, therefore, creates a culture that ultimately leads to frustration and erodes the performance of the economic system.¹³

Like Conservatives, Radicals believe in objective standards of value that exist independently of individual preferences. This belief provides the basis for a moral obligation to defend “good” culture and suppress “bad” culture. For example, some Radicals have proposed that free speech should be restricted to prevent language deemed offensive to historically oppressed groups such as women and minorities.¹⁴ Several colleges and universities

have established rules barring “hate speech,” and Radicals have disrupted public lectures by speakers with whom they disagree. However, most Radicals defend the importance of tolerance, knowing that censorship in a capitalist society is most likely to be used to repress Radical ideas and art forms.

THE CONSERVATIVE PERSPECTIVE

The Purpose of Education

The Conservative view of education is shaped by the belief that humans have limited capacity for exercising reason and virtue. Education entails the transmission from one generation to the next of the wisdom and cultural achievements of the past. Formal education shapes youth into responsible adults prepared to fill appropriate positions in the social hierarchy. Education should impart knowledge of the timeless, objective values that have historically guided humans toward virtuous behavior and social order. Knowledge consists not simply of skills and techniques but also encompasses morality and culture. By teaching traditional values such as patriotism, obedience, respect, honor, reverence, civility, and loyalty, education preserves and legitimizes the hierarchical society.

The Conservative view of education was clearly articulated by Allan Bloom (1930–1992), a Classics professor at the University of Chicago.¹⁵ Bloom claimed that higher education in the United States had been badly damaged by egalitarian attacks on authority launched during the 1960s. As students demanded and were granted greater participation in university governance and curriculum design, they proceeded to dismantle the hierarchical control that made genuine education possible. Universities seeking “relevance” abandoned the study of classic texts providing the basis for “Western civilization.” Professors’ expertise was devalued as classrooms became open forums in which every participant’s opinion was considered equally valid. Bloom extended his criticism to include many professors, themselves the products of the 1960s, who encouraged students to rely on their own opinions and judgment. By contrast, Bloom believed that young minds must be carefully cultivated and molded by skilled educators. Students lacking sufficient wisdom to discern truth and virtue should have little input in determining the nature of their education.

Educational Policy

The Conservative educational agenda focuses on three issues. First, the “wisdom of the ages” must be protected from the corrosive effects of individualism, materialism, and the liberal notion that individual preferences are the basis of all values. Second, the unequal capacities of students for learning must be fully acknowledged in structuring the educational system. Third, control over education should be placed securely in the hands of scholars and professional administrators. We shall examine each of these principles and the specific policies flowing from them.

1. *Preservation of knowledge.* At the university level, Conservatives favor a curriculum built around the literary classics, including the works of Plato, Aristotle, Cicero, Homer, Augustine, and Aquinas. They assume that these thinkers presented enduring truths as relevant today as they were in antiquity. This commitment to the classics, known as “perennialism,” insists on the unchanging nature of truth and wisdom and opposes curricular reforms reflecting contemporary intellectual trends.

Conservatives emphasize the need for instruction in values and character development as an integral part of the educational process. Students need moral education because their untutored instincts are not reliable guides to virtue. Education that purports to be value-free leads to ethical relativism in which individuals are free to choose their moral principles. To facilitate the teaching of values, many Conservatives favor prayer and the option for religious instruction in public schools. In addition, they support tax credits for tuition paid to private schools in which religious education can be integrated into the entire curriculum. To promote private and parochial schools, Conservatives join with Classical Liberals in supporting school choice through government-issued educational vouchers, which can be redeemed at any accredited school.

Conservatives also want school curricula to promote patriotism, claiming that loyalty to one’s country is essential to political unity and strength. Conservatives typically oppose bilingual education in public schools, fearing that a multilanguage society would lack the cohesiveness and shared identity required for both internal order and defense against external threats. In addition, Conservatives often oppose sex education in schools, claiming

that it promotes promiscuity and undermines parental authority. Instead of sex education, schools should promote abstinence. Some Conservatives, particularly those with a fundamentalist religious orientation, have attempted to control the selection of textbooks in public schools, claiming that most current texts are based on ethical relativism and secular humanism. Religious fundamentalists also oppose the teaching of evolution, claiming that it contradicts the Biblical account of creation and, therefore, casts doubt on the truth of Christian moral principles.

2. *Unequal education.* According to Conservatives, students vary in their cognitive abilities and, therefore, need different methods of education.¹⁶ Based on early tests of intelligence, Conservatives advocate assigning students to educational tracks designed to prepare them for adult roles that best suit their capabilities. University education for future elites should consist of rigorous intellectual training in the arts, humanities, and sciences, while de-emphasizing vocational training and extracurricular activities. Less capable students should be placed in tracks leading to professional training in business, while the least able students should be steered toward vocational training with an emphasis on manual skills.

Equal education fails to provide the most capable students with challenges suited to their abilities and overwhelms and discourages less intelligent students. Conservatives tend to oppose standardized testing because it assumes that all students should acquire the same knowledge and skills. According to Bloom, the commitment to equal educational opportunity has ruined the modern university. He claimed that only a select number of students are genuinely suited to a scholarly education. By accepting most high school graduates, many universities have transformed themselves from institutions of higher learning into glorified vocational schools simply preparing students to earn a living. The ideal of the university as a community of scholars in search of truth has been sacrificed to the egalitarian ethic of mass society.

3. *Hierarchical control.* At the university level, Conservatives believe that only professional administrators and senior faculty members possess the knowledge and experience to design curricula and educate the elite

students who will lead the next generation. At the elementary and high school level, Conservatives are more ambivalent concerning the issue of who should determine curricula and teaching methods. Teachers and administrators are often unionized and may exhibit the same narrow pursuit of material self-interest that infects society as a whole. Government control, particularly at the federal level, results in a mandated common core curriculum that may be insensitive to the cultural heritages of local communities. Parents and community leaders lack professional expertise to design curricula. Recognizing the inherent weaknesses of each group, Conservatives propose that administrators work together with state boards of education, teachers, and parents to assure that schools reinforce and supplement the moral instruction received by children at home.

The Role of Culture

From the Conservative perspective, culture creates shared meaning and social bonds between individuals and preserves the wisdom and achievements of past generations.¹⁷ Culture provides the context within which individuals develop their values and interests. Without culture, individuals would be isolated and lack the emotional and moral sustenance of society's collective wisdom and traditions. While schools are important in transmitting culture, the process of acculturation occurs in all dimensions of human existence. Any society's culture reflects the diversity of its different groups, but a healthy society should manifest sufficient cultural homogeneity to generate the allegiance of all citizens. This emphasis on cultural homogeneity explains why Conservatives propose making English the official language of the United States.

Conservatives express deep concern about the quality of culture. In the 19th century, critics such as Matthew Arnold (1822–1888) and Henry Adams (1838–1918) decried the banality and crassness of contemporary culture.¹⁸ According to Arnold, “freedom is a very good horse to ride, but to ride somewhere.” In other words, the Classical Liberal conception of freedom as the absence of coercion is potentially dangerous without strong moral principles to guide individuals in making wise choices. In the 20th century, Conservative writers developed the concept of “mass society” to describe the mindless conformity and cultural degeneracy of modern life.

Individuals in mass society lose the capacity for independent thought and seek only passive forms of entertainment making few demands on their intellectual or artistic capacities. Spanish philosopher Jose Ortega y Gasset (1883–1955) attributed the rise of totalitarianism to the loss of meaning and personal identity that accompanies mass society.¹⁹ Writer and poet T. S. Eliot (1888–1965) described modern culture as “the waste land.”

For Conservatives, popular culture is the visible expression of the state of mind of the masses. A crude and decadent culture reveals more than just bad taste; if culture is in decline, this reflects inner turmoil in people’s lives, which jeopardizes the economic and political strength of the nation. Nineteenth-century Conservatives blamed both democracy and capitalism for the deterioration of culture. Capitalism’s mass production undermines creativity and skills, leading to mediocrity, moral decay, and insipid consumerism. The insatiable drive for profits causes producers to “inflamm the appetites” of consumers and undermines the traditions and stability essential to an orderly society. Both democracy and capitalism erode culture by permitting the values and tastes of the masses to override the wisdom and virtue of the elites in establishing public policy and social norms.

By the middle of the 20th century, after witnessing both communism and fascism, most Conservatives suppressed their qualms about democracy and capitalism. Instead, they joined with Classical Liberals in blaming government for the deterioration of culture.²⁰ With political power concentrated at the national level, government programs to provide welfare and security have the unintended consequence of undermining the intermediate institutions of family, church, and cohesive communities. Without the structures of authority provided by these institutions, isolated individuals face the intimidating task of fashioning personal identities in a society offering few guidelines. Conservatives attribute obscene language, pornography, sexual promiscuity, and drug use to the anxiety arising when individuals lack meaning and purpose in their lives.

For Conservatives, the classics of literature, music, and art provide standards of eternal beauty and excellence. Culture should express shared values and traditions, but when society is increasingly fragmented and devoid of standards, culture instead reflects anger, resentment, cynicism, skepticism, and alienation. Lacking traditional cultural forms to emulate

and develop, artists, musicians, and writers produce abstract, surreal, dissonant, and shocking expressions. Conservatives criticize rock music for its pulsing beat and suggestive lyrics designed to arouse the passions and alleviate the anxieties of alienated youth. The drug culture pervading modern societies is, for Conservatives, the logical culmination of liberalism in which pleasure is the sole measure of value. Conservatives regard many contemporary intellectuals, writers, musicians, journalists, and artists as member of a “new class” or “adversary culture” consciously seeking to subvert traditional society. Sociologist Daniel Bell (1919–2011) described an inherent conflict between economy and culture in capitalist society. The economy needs self-disciplined, obedient workers who are able to delay gratification, while capitalist culture breeds hedonism and rejection of authority.²¹

For Conservatives, combatting the corrosive influences of capitalism and democracy requires concerted efforts to restore the traditional intermediate institutions of family, church, and community. To resist the spread of secular humanism and hedonism, Conservatives engage in “culture wars” with liberals to reverse the disintegration of modern societies.²² To resuscitate traditional values, Conservatives support prayer in schools, Christmas displays in public spaces, and laws against abortion, pornography, and same-sex marriage.

THE MODERN LIBERAL PERSPECTIVE

The Purpose of Education

The Modern Liberal view of education owes much to the U.S. philosopher John Dewey (1859–1952).²³ Dewey’s educational philosophy, which came to be known as “progressivism,” was based on his concerns that the evolution of society from the rugged individualism of the 19th century to the corporate capitalism of the 20th century had rendered traditional educational methods obsolete. Reflecting the Modern Liberal skepticism toward the notion of eternal truths and values, Dewey called on

educators to prepare students for this new society by cultivating their capacity for critical and independent thinking. Students should be encouraged to objectively assess the facts of any situation and the potential consequences of any action. Extending Dewey's ideas, Modern Liberals currently focus on the following three purposes of education:

1. *Personal development.* Modern Liberals believe that education can awaken talents and aspirations in students that might otherwise remain dormant. Education encourages individuals to reach beyond their current interests and social status by developing respect for other individuals and cultures. Personal development was the focus of three of the most prominent developmental psychologists of the 20th century—Jean Piaget (1896–1980), Lawrence Kohlberg (1927–1987), and Abraham Maslow (1908–1970).²⁴ Their research led them to conclude that every human being passes through stages of moral and emotional maturation, potentially culminating in a full and meaningful life that Maslow called “self-actualization.” However, this evolution can be blocked by poverty, ignorance, and oppression. Therefore, Modern Liberals consider equal access to high-quality education as essential to enabling both children and adults to achieve their full potential.

2. *Social justice.* Modern Liberals believe that human abilities are more similar than the present distribution of income would suggest, and that differences in the quality of education received by children from different family backgrounds play a significant role in perpetuating social and economic inequality. If every child had the same education and equal opportunity to compete for jobs, then ability and effort would become more important than family status in determining economic success, and, over time, the distribution of income should become increasingly fair. Equal education can break the generational cycle that causes many children to face limited opportunities due to their impoverished backgrounds. Public education also fosters a sense of shared culture among children from widely divergent family backgrounds, thereby contributing to the cohesiveness and stability of society.²⁵

3. *Economic efficiency.* Using the metaphor of the United States as “the great melting pot,” Modern Liberals view education as the flame that keeps the broth bubbling so that individuals have the opportunity to achieve their full potential. Like Classical Liberals, Modern Liberals view education as a means for increasing economic efficiency by raising productivity through public investment in “human capital” that will pay dividends in terms of higher future productivity and income. Public funding for education corrects a positive externality that impairs the efficiency of the market. In addition to the benefits conferred on individual students in the form of higher future earnings and enhanced personal development, education creates benefits for society as a whole such as lower crime rates, less need for welfare, increased tax revenue from the higher earnings of educated citizens, and improved democracy due to widespread literacy and involvement in public affairs. Because the social benefits of education exceed the private benefits, the market fails to produce the optimal amount of education. Government funding of education is essential to achieve economic efficiency.²⁶

Educational Policy

Since formal education is only one component of children’s socialization, providing identical educational experiences to children from vastly different family backgrounds is not sufficient to secure equality of opportunity in the labor market. Modern Liberals favor compensatory education to provide instruction designed to overcome the disadvantages facing children from deprived backgrounds. These disadvantages may include not only low academic skills, poor health, and inadequate nutrition but also lack of motivation due to the absence of role models or prospects for success.

Modern Liberals are strongly committed to the public school system and have been critical of proposals for either a voucher system or tax credits for tuition to private schools.²⁷ Both policies, they claim, would encourage increased racial and class segregation of students as affluent families abandon public schools. In contrast, low-income families, unable to afford transportation, would have no choice but to send their children to neighborhood public schools. The best teachers would relocate to the more

attractive suburban and private schools, and the goal of equal education for all students would be sacrificed.

The concept of “merit pay” to reward more talented teachers is also opposed by most Modern Liberals. If student scores on standardized tests are the criterion for assessing merit, teachers may orient their efforts toward preparing students to perform well on the tests while neglecting other areas of instruction. Giving administrators authority to determine teachers’ merit could discourage innovation and raise issues of favoritism and discrimination. Merit pay could also have a divisive and demoralizing effect on teachers by placing them in competition with each other rather than promoting cooperation and mutual support. Instead of merit pay, Modern Liberals propose various forms of public recognition such as Teacher of the Year awards to provide incentives for excellence in teaching.

In the past, Modern Liberals favored busing students to achieve racial balance throughout a school district.²⁸ They argued that public schools cannot provide equal education for all students when neighborhoods are segregated and schools are funded through property taxes. However, initial experiments with busing were disappointing. In some cases, parents either relocated or enrolled their children in private schools in order to avoid busing. Neighborhoods lost cohesion as children were bused to distant schools, and many students did not perform well in unfamiliar environments. Recognizing these problems, Modern Liberals have refocused their attention on improving neighborhood schools and supporting open enrollment for all schools within a district.

Modern Liberals support efforts to introduce moral education into the public school curriculum. However, while Conservatives typically link moral education with religious instruction, Modern Liberals simply want to provide students with a forum in which they can clarify their own values through discussion of hypothetical situations. The values Modern Liberals hope to impart to students include tolerance, compassion, honesty, and respect for the rights of others. Recent examples of values-oriented education include programs devoted to multiculturalism, antibullying, conflict resolution, and awareness of LGTB issues.

In 2002, educational reform legislation known as No Child Left Behind (NCLB) was initially supported by both Modern Liberals and Classical

Liberals.²⁹ Modern Liberals were attracted by the increased role of the federal government in establishing a common core curriculum to assure that all students were receiving equal education. Classical Liberals supported greater accountability for schools and teachers and the increased emphasis on charter schools, which are publicly funded but privately administered, to increase competition with publicly-administered schools. Accountability was based on the results of annual testing to assess learning, and those schools whose students failed to demonstrate progress in meeting national standards were penalized. If a school failed to perform for four consecutive years, teachers could be replaced, and a fifth year of poor results would result in closing the school and opening a charter school or private school.

NCLB was given further impetus in 2009 when the federal government initiated Race to the Top that approved merit pay for teachers and provided over 4 billion dollars in grants to schools demonstrating innovation and reform. However, opposition to NCLB has grown in recent years. Both Conservatives and Classical Liberals object to federal government control over curriculum and standardized testing, arguing that local communities should have discretion over such matters. Modern Liberals object to merit pay for teachers and claim that standardized tests do not accurately measure the quality of teaching. In low-income areas, low test scores may be the result of broken families and dangerous neighborhoods rather than the quality of teaching. Schools and teachers should not be penalized for circumstances beyond their control. Substandard schools should receive additional funding to compensate for the challenges facing students from deprived backgrounds. Responding to these criticisms, the U.S. Congress enacted legislation in 2015 to substantially reduce the role of the federal government in establishing a common curriculum, mandating standardized tests, and penalizing schools for failure to meet performance standards. State and local governments and school boards were given greater control over these issues.

In the face of growing concern about the United States' ability to compete in global markets, Modern Liberals increasingly emphasize the role of education in enhancing efficiency and growth.³⁰ In making decisions concerning the allocation of resources to public education, Modern Liberal economists rely on cost-benefit analysis. They calculate the financial

benefits created by dollars spent on education compared to other types of government spending. In higher education, economists assess the benefits of spending on different departments within the university and on university education versus vocational education. The goal is to allocate funds to education in a manner that maximizes future gains in productivity and national income. The pitfall associated with cost–benefit analysis is that by focusing on measurable changes such as individual earnings and GDP, economists may overlook the intangible benefits of education, including political stability, social equality, and personal development.

The Role of Culture

Ambiguity in the Modern Liberal approach to culture can be traced back to John Stuart Mill. On one hand, Mill defended the Classical Liberal view that individuals have the right to exercise any cultural practices that do not harm others. Yet Mill also appealed to the notion of a hierarchy of pleasures based on “the permanent interests of man as a progressive being.” According to Mill, although humans are capable of experiencing a variety of pleasures, some pleasures are demeaning and ultimately destructive, while others are uplifting and contribute to the full realization of human potential. Mill claimed that intellectual and artistic expressions are the highest forms of pleasure because they exercise the uniquely human capacities for reason and creativity. In contrast, pleasures such as eating and procreation are common to all animals and, therefore, are lower forms of pleasure.

Modern Liberals waver between Mill’s call for tolerance of nearly all forms of cultural expression and his effort to establish moral criteria for distinguishing between high and low culture. Tolerance usually prevails unless some aspect of culture is viewed as potentially harmful to the well-being of others, particularly members of minority groups. For example, Modern Liberals oppose flying the Confederate flag over southern state capitols because they associate the flag with the defense of slavery during the Civil War.

Modern Liberals are staunch defenders of tolerance toward a wide array of cultural expressions. They value the experience of choosing among diverse alternatives. When cultural variety exists, individuals develop their

capacity for judgment and choice. Even if their choice is unwise, the experience of choosing is important to their personal development. Only through experimentation with alternatives will individuals come to know and value higher forms of culture. In addition, Modern Liberals are concerned that widespread efforts by government to regulate cultural expression would eventually lead to censorship and repression. While Mill's notion of a hierarchy of pleasures provides Modern Liberals with a rough criterion on which censorship might be based, the commitment to tolerance leaves most Modern Liberals with little inclination to suppress any form of culture.

However, Modern Liberals believe that government can play an important role in improving culture.³¹ Government should subsidize public television, symphony orchestras, and art museums. The economic rationale for such support lies with the positive externalities associated with exposing a wider audience to the arts. Individuals with more highly developed cultural tastes are likely to be better citizens, civic leaders, and productive workers. Modern Liberals also believe that government can indirectly promote higher forms of culture by reducing the unemployment and poverty that contribute to frustration and nihilism in modern societies. When economic opportunity is elusive, people vent their anger in various destructive behaviors such as drug abuse. Rather than attacking the symptoms of alienation through repression or censorship, Modern Liberals propose economic revitalization as the only viable solution to cultural decline.

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Chapter 14

Pollution and the Environment

The economist Kenneth Boulding (1910–1993) coined the term “cowboy economy” to describe a condition of limitless resources and unproblematic disposal of waste. However, he argued that the modern economy is better described as “spaceship earth,” hurtling through the cosmos with finite resources and limited capacity to dispose of waste without jeopardizing human survival. In light of environmental problems including global climate change, acid rain, deforestation, elimination of species, depletion of aquifers, destruction of the ozone layer, desertification, air and water pollution, and the accumulation of toxins in the food chain, environmental issues have come to the forefront of political economy.

In 1972, a group of scientists at the Massachusetts Institute of Technology ran computer simulations in an effort to determine how much longer mankind could continue to degrade the environment without jeopardizing the earth’s capacity to sustain human life. Using current rates of growth of variables such as population, food supply, industrial production, pollution, and resource depletion, they concluded that if current trends continued, ecological catastrophe would occur sometime during the 21st century.¹ That study has since been challenged, but today, global climate change has become the issue that may finally force citizens and their governments to fully acknowledge the danger posed by environmental

degradation. If coastal cities are threatened by rising ocean levels and increasingly severe storms and droughts wreak havoc on local populations, the idea of limiting economic growth to sustainable levels will gain wider acceptance. In the meantime, economists and policy makers continue to debate the appropriate response to deterioration of the planet's multiple ecosystems.

THE CLASSICAL LIBERAL PERSPECTIVE

Causes of Pollution As an outgrowth of the 18th-century Enlightenment's commitment to the ability of human reason to fully understand the external world, Classical Liberalism views the natural environment as physical matter to be controlled and manipulated for the purpose of serving human interests. Classical Liberals attribute pollution and resource depletion to the following causes: 1. *Consumer preferences*. Consumers are free to choose between less expensive goods produced without the cost of controlling pollution or more expensive goods whose price reflects the additional cost of ecologically sound methods of production. If polluting firms survive in the competitive market, then consumers apparently have indicated their preference for paying lower prices rather than maintaining a cleaner environment. Corporations should not be blamed for pollution since they are simply responding to consumer preferences. Classical Liberals defend the right of consumers to place a higher value on consumption of material goods than on environmental purity.

2. *Lack of private property*. Because certain domains such as rivers, lakes, oceans, and the atmosphere are not privately owned, individuals and firms are able to use them as free disposal sites without violating any individual's property rights. If these domains were privately owned, polluters would have to negotiate with owners over payment for damages or else face lawsuits. Economist Ronald Coase (1910–2013) proposed that under certain restrictive assumptions, polluters could negotiate deals with

private owners of disposal sites that would result in an “optimal level of pollution” regardless of who owns the site.² For example, if a polluting corporation owned a nearby lake and used it for waste disposal, local citizens who want a clean lake could bargain with the corporation to reach an agreement about how much money the citizens would pay in order to compensate the corporation for the cost of alternative waste disposal. In theory, citizens would be willing to pay for reductions in pollution until the cost of further pollution abatement is equal to the additional benefits of having a cleaner lake. Any further reduction in pollution would be economically inefficient since the additional cost to the citizens would exceed their additional benefit. Alternatively, the lake might be owned by any citizen. In that case, the corporation would pay the citizen for use of the lake as a disposal site. Again, Coase argued, the optimal level of pollution would result since the corporation would be willing to pay the owner of the lake up to the point at which the additional cost equals the additional benefit to the corporation. In summary, if all domains were converted to private property, a market for the right to pollute would arise, resulting in an efficient allocation of resources without the need for government regulation.

3. *Transaction costs.* Transaction costs are the costs of making exchanges in the market not directly related to the production of a good or service. Examples include the costs of gathering information, negotiating the terms of trade, preparing legal documents, and monitoring and enforcing compliance with a contract. Coase acknowledged that bargaining between polluters and owners of disposal sites would result in an “optimal level of pollution” only when transaction costs were negligible. In the foregoing example, the citizens willing to pay the corporation to reduce pollution may face substantial transaction costs in collectively organizing themselves to express their preference for a cleaner lake, collect money from each citizen, and monitor compliance with whatever agreement is made. The transaction costs may be sufficiently high to deter the citizens from negotiating a deal, and a market for the right to pollute will fail to materialize.

4. *Lack of development.* Contrary to the notion that economic growth leads to more pollution, Classical Liberals claim that environmental destruction is often associated with low levels of economic development. Less developed countries (LDCs) typically have higher rates of population growth, less efficient use of raw materials, fewer synthetic materials, and less technical capacity to protect the environment. Moreover, the pressures of subsistence living often force citizens in LDCs to engage in practices harmful to the environment such as dumping waste into rivers or burning trees for firewood. Economic prosperity enables societies to reduce pollution by developing synthetic substitutes for natural resources, more energy-efficient technologies, and technologies for reducing or repairing environmental damage. The free market is the best institution for achieving prosperity and, therefore, provides the surest means to protect the environment.

Environmental Policy Classical Liberals are skeptical of, if not opposed to, government efforts to protect the environment for the following reasons: 1. *Lack of information.* Classical Liberals claim that the government lacks sufficient information about the costs and benefits of reducing pollution in various industries and, therefore, will inevitably impose environmental standards that interfere with economic efficiency. When the U.S. government began significant efforts to control pollution after the formation of the Environmental Protection Agency in 1970, bureaucrats relied on easily enforced uniform pollution standards applicable to all industries. The problem with pollution standards is that the costs and benefits of reducing pollution differ dramatically among industries. A standard that is easily met in one industry may drive firms in another industry out of business.

2. *Special interest groups.* Classical Liberals believe that various special interest groups have selfish motives for advancing environmental protection.³ For example, Classical Liberals claim that environmental organizations such as the Sierra Club, the Wilderness Society, and Greenpeace solicit membership fees and donations by frightening the public with exaggerated claims of impending environmental disaster.⁴ Climate

scientists have a vested interest in supporting the concept of man-made climate change in order to increase funding for their research. Government bureaucrats benefit when funding for their agency is increased in order to protect the environment. Classical Liberals suggest that Modern Liberals and Radicals rely on the specter of global climate change and other environmental threats to promote their goal of greater government control over the market. When these special interest groups are successful in using government to advance their own agendas, the resulting array of extreme and complicated regulations cripples the economy and, therefore, harms all citizens.

3. *Constitutional rights.* The Fifth Amendment to the U.S. Constitution states: “nor shall private property be taken for public use without just compensation.” Whereas the usual interpretation of this so-called takings clause is that government must pay private owners when it takes land or houses for a public purpose such as building a highway, Classical Liberals have argued that government must compensate owners any time a regulation reduces the value or profitability of private property.⁵ If government had to bear the full cost of regulations by compensating owners for any lost value, the number of regulations would decline dramatically. For example, zoning laws, laws to protect endangered species, and laws to protect wetlands would become prohibitively expensive for government.

Rather than relying on government to protect the environment, Classical Liberals suggest that the free market is capable of solving many environmental issues.⁶ They point to the following attributes of the market that make it suitable for protecting the environment: 1. *Scarcity pricing.* As any natural resource is depleted, its price will rise due not only to its current scarcity but also to the anticipated higher costs of extracting that resource in the future. As a result of “scarcity pricing,” both consumers and producers will search for less expensive alternative resources and firms will face incentives to develop new technology for producing synthetic substitutes and to search for additional reserves of the resource.

2. *Least-cost method of production.* Competition in the market creates strong pressures on firms to produce goods and services at the lowest possible cost. Those firms failing to adopt the least-cost method of production will be unable to match the price of their competitors' goods and will eventually be driven out of business. One way to reduce costs of production is to use fewer resources, so the market protects the environment by requiring firms to conserve on the use of natural resources.

3. *Prosperity.* Classical Liberals claim that the market fosters rising incomes and wealth and that this prosperity protects the environment. First, consumers who have attained higher standards of living are more likely to value a clean environment. Corporations may cater to these consumer preferences by producing eco-friendly products, which makes environmentalism profitable. Second, prosperity creates the financial means for corporations to invest in developing and adopting cleaner, more environmentally sound technology. Finally, the historical record demonstrates that rising standards of living are associated with lower birth rates, thereby easing population pressures on the environment.

4. *Entrepreneurship.* Classical Liberals argue that private entrepreneurs can solve many environmental problems by discovering opportunities where high transaction costs have prevented a market for pollution rights from forming.⁷ These entrepreneurs, or "enviro-capitalists," can serve as middle men facilitating negotiations between polluters and those who are damaged by pollution. For example, a group of commercial fishermen could conceivably pay a factory owner to reduce pollution that harms the fish population. The cost of securing agreement among the fishermen, determining the size of the offer, and enforcing a contract might be sufficiently high to deter the fishermen, but an entrepreneur with expertise in negotiating, monitoring, and enforcing such deals may be able to reduce the transaction costs to the point where an agreement by both sides is feasible and the entrepreneur makes a profit.

5. *Technological innovation.* Damage to the environment creates profitable opportunities for the development of new technologies to reduce

pollution and restore ecological balance. Indeed, international competition provides strong incentives for innovation since the first firm to develop a new environmental technology can sell to a global market. For example, climate change has led to the rise of “climate engineering” as firms develop techniques such as growing large beds of algae in the ocean to absorb carbon dioxide or releasing reflective particles into the atmosphere to form clouds and block sunlight.⁸

6. *Private property.* Classical Liberals believe that private property rights provide a strong deterrent to pollution since owners will either charge for use of their property as a disposal site or rely on the legal system to sue for damages.

While proposals to privatize ownership of coastlines, lakes, or small streams may be feasible, Classical Liberals acknowledge that private ownership of large rivers, the oceans, and the atmosphere is impractical because water and air do not stay in the same place. As a result, most Classical Liberals accept some role for government in protecting the environment. They propose the following forms of government intervention designed to interfere with the market as little as possible: 1. *Effluent fees.* An effluent fee is a tax on the emission of pollutants. A tax on pollution simply changes the incentives facing producers without mandating any specific action. Whereas pollution standards set by government require all firms to meet the same standards regardless of different production processes, a tax leaves firms free to choose what method of waste disposal and what level of production will maximize their profit. A higher tax on emissions creates a greater incentive for firms to reduce pollution.

2. *Pollution licenses.* Relying on a policy called “cap-and-trade,” government determines an acceptable level of pollution and then auctions a limited number of licenses to pollute to the highest bidders. Those firms whose pollution is most costly to reduce will presumably bid highest for licenses, and those firms able to reduce pollution inexpensively will forego a license and simply incur the cost of reducing their pollution. After the

licenses are auctioned by government, firms are free to resell them, thereby creating a market for the right to pollute and enabling firms to adjust their waste disposal in response to changing market conditions.

3. *Cost–benefit analysis*. Before any environmental regulation is enacted, Classical Liberals call for a thorough assessment of whether the benefits of the regulation outweigh the costs in terms of monitoring and enforcement as well as restricted opportunities for businesses. For example, the government would have to demonstrate that the dollar value of a protected animal or plant species exceeds the dollar value of using its natural habitat for economic purposes. Any regulation failing to meet this standard would be eliminated. Cost–benefit analysis would assure “wise use” of resources, protecting the environment only to the point where the costs of additional protection outweigh the benefits.⁹

In response to those who defend environmental regulations on the grounds that future generations have a right to adequate resources and a healthy environment, Classical Liberals claim that individual liberty and free markets are the best guarantee of well-being for our descendants. The incentives and efficiency associated with free markets propel economic growth, which generates the financial resources and technology to protect and restore the environment. Heavy-handed environmental regulations will actually damage the environment, they suggest, by causing a stagnant economy in which citizens and businesses will be more concerned with daily survival than with the quality of the environment. Ultimately, then, there is no trade-off between economic growth and environmental integrity.¹⁰

THE RADICAL PERSPECTIVE

Causes of Pollution Radicals believe that capitalism is the fundamental cause of environmental degradation. They point to the following features of capitalism that contribute to pollution and exhaustion of resources: 1. *Private property*. Radicals argue that private property breeds self-interest so that individuals focus only on matters affecting them directly. With

human energies focused on protecting and increasing personal property, little attention is given to public resources such as the environment.

2. *Competition.* The market generates competitive pressures on firms to adopt the least-cost method of production. One way to reduce production costs is to use the environment as a free site for waste disposal. Even if some capitalists personally value clean air and water, disposing of waste in an ecologically sound manner is typically more expensive and, therefore, erodes any competitive advantage their firms may possess. So, in the absence of government regulation, market competition essentially forces firms to pollute. Market competition also pressures firms to engage in “planned obsolescence,” which forces consumers to replace products more frequently, resulting in increased waste. Another aspect of competition is advertising, which fosters new desires for commodities and, therefore, leads to more rapid depletion of resources.

3. *Class conflict.* Capitalism generates a high degree of inequality in the distribution of income and wealth and, therefore, breeds a mixture of envy, resentment, and a sense of injustice among many citizens. The lifestyles of the rich set cultural standards to which lower-income families aspire. Conspicuous consumption becomes the norm as citizens seek to display their social status, resulting in ever-increasing stress on the environment.

4. *Growth imperative.* Capitalism has been compared to a bicycle—it either moves forward or topples over. In order to thrive, capitalism requires continual new investment opportunities, which arise due to increased production and consumption of goods and services. According to Radicals, capitalism requires economic growth, and growth causes further depletion of resources and additional pollution.

5. *Lack of political control.* In a market economy, individuals are relatively powerless to halt pollution. They may purchase eco-friendly products, but this action is unlikely to reduce pollution unless most other consumers do the same. Since eco-friendly products are typically more expensive, each consumer has an incentive to purchase cheaper products and hope that someone else will make the sacrifice of buying more

expensive products in order to protect the environment. The only way for individuals to overcome this “collective action problem” is to engage in the political process to establish production standards and other forms of environmental policy. However, given the political clout of corporations in capitalist societies, these efforts to protect the environment through government are likely to be stymied by lobbying and campaign contributions from corporations and powerful interest groups.

6. *Alienation.* Capitalism erodes traditional communities and social bonds, leaving individuals isolated and insecure. This alienation from one’s society causes individuals to lower their expectations of social solidarity and instead focus on what capitalism does well—providing commodities for private consumption.¹¹ Individuals learn from experience to structure their lives around consumption and ownership as the primary sources of satisfaction. Conversely, because capitalism is not well suited to providing public goods such as a clean environment and mass-transit systems, individuals tend to devalue those goods and rely instead on commodities such as water filters and automobiles. Radicals argue that developing and exercising the human capacities for creativity, artistic expression, athleticism, appreciation of nature, and cultivation of friendships would actually bring greater satisfaction while requiring relatively few natural resources and, therefore, easing stress on the environment.

Some Radicals extend the critique of capitalism to include the Enlightenment tradition that formed the basis for both capitalism and communism as practiced in the Soviet Union and China. Both systems shared the Enlightenment view of mankind’s domination over nature and consequently placed higher priority on economic growth than on protecting the environment. In 1972, Swedish ecologist Arne Naess (1912–2009) proposed the term “deep ecology” to describe a view of nature as a holistic system consisting of diverse yet interdependent species and elements.¹² Nature seeks equilibrium between all its subsystems, so any disruptive force in one area may have extensive and unforeseen repercussions throughout the ecosystem. Deep ecologists blame environmental degradation on the anthropocentric worldview inherited from the Enlightenment by both Classical Liberals and Marxists, which treats nature as physical matter to be

manipulated for human purposes. Instead, deep ecologists view humans as simply one part of a larger ecosystem. From this perspective, since humans are not privileged above other species, they have a moral duty to treat nature with reverence and humility.

The implications of deep ecology can be startling. If all species are equally privileged, then animals possess the same rights as humans. Deep ecologists condemn painful experiments on animals to test products for human use, and some even include soil and water as components of a “moral community.”¹³ Earth is a living organism, and all species and elements are simply parts of the whole. British ecologist James Lovelock has named this organism after the Greek goddess “Gaia” and suggests that any species damaging the environment will be eliminated by Gaia just as the human body destroys a virus.¹⁴

Deep ecologists and other environmentalists differ in their conflicting rationales for protecting nature. Most environmentalists believe in preserving nature to make the world more livable for humans, and they appeal to the pleasure gained from wilderness experiences, recreation, healthful food, clear air and water, and continued availability of resources. Deep ecologists, in contrast, claim that our planet should be protected even if doing so requires sacrifices in material standards of living. Deep ecologists might favor restricting human access to wilderness areas to preserve the integrity of the environment. Some deep ecologists have suggested that protecting nature from overpopulation might require “harvesting” humans to reduce pressures on the environment. From this perspective, AIDS and the Ebola virus may be viewed as Gaia’s method of harvesting humans.

To highlight the weaknesses of Marxism, deep ecologists point to the poor environmental record of countries that experimented with communism. Other Radicals respond by noting that communism appeared primarily in LDCs where rapid industrialization was essential to win political support for new revolutionary governments. They assume that a postcapitalist system can be more sensitive to the environment when higher standards of living have been achieved.¹⁵

Environmental Policy Radicals have not formed a consensus on how best to protect nature. For the near term, they support the following government efforts to control pollution and resource depletion: 1.

Regulation. Radicals favor more stringent government regulations that would force corporations either to eliminate most polluting practices or else pay the full cost of any damage they impose on the environment. Corporations would undoubtedly attempt to preserve profitability by raising product prices, but Radicals accept that consumers should pay a price equal to the full cost of producing a good, including the cost of preventing environmental degradation. The adverse effects of higher prices on low-income households could be offset by granting tax credits.

2. *Public ownership.* Given the disillusionment resulting from the experience of communism in the Soviet Union and China, most Radicals oppose widespread government ownership of industry. However, the fossil fuel-based energy industry is not only a major source of pollution but also a natural monopoly in many areas. Therefore, some Radicals support public ownership of energy firms such as electric utilities and oil companies as well as government subsidies to encourage the development of technologies for generating alternative sources of energy such as wind and solar.

3. *Democratic planning.* Again, the poor performance of centralized planning in the Soviet Union and China caused Radicals to reassess the efficacy of planning. However, Radicals place much of the blame for pollution on the market, which recognizes consumer demand only for commodities and not for public goods such as a clean environment. Therefore, Radicals continue to support a degree of planning so that social goals beyond profit maximization are incorporated into decisions concerning the allocation of resources.¹⁶ By enabling citizens to act collectively, planning empowers them to achieve a sustainable natural environment. This planning would be democratic in the sense that government would consult with various interest groups.

Given the political power of entrenched interest groups, Radicals doubt that any of these policies will be enacted in the near future. Damage to the environment will probably continue until an ecological catastrophe such as global climate change awakens the public to the need for fundamental reform in the economic system.¹⁷ In anticipation of that transition, Radicals have formulated a variety of proposals for constructing a sustainable economic system and protecting the environment.¹⁸

1. *An end to growth.* Some Radicals claim that environmental sustainability will require an end to economic growth.¹⁹ However, halting growth under capitalism would be both infeasible and undesirable. The viability of the system depends on ever-expanding production, and issues such as poverty and inequality would likely worsen without growth. In a postcapitalist society, Radicals anticipate that the combination of economic planning to supplement the market and a more equitable ownership of resources would enable all mankind to enjoy a comfortable standard of living without continual growth.

2. *Global governance.* Globalization has undermined the effectiveness of many existing institutions designed to protect the environment.²⁰ Any nation imposing stringent environmental regulations may experience a loss of production and jobs as firms move abroad seeking to escape regulation. Radicals argue that a global economy requires global regulations enacted and enforced by a global governing agency. Conceivably, an agency similar to the World Trade Organization could administer worldwide environmental regulations.

3. *Economic justice.* Radicals believe that a more equitable distribution of ownership of resources and the resulting distribution of income would relieve stress on the environment by reducing the conspicuous consumption characteristic of capitalist societies. If wealth and ownership were no longer the primary sources of social status, individuals would focus their energies on activities such as artistic expression, recreation, and friendship that require relatively few natural resources. On a global scale, a more equitable distribution of resources would also ease pressures on the environment by

reducing the rate of population growth as parents in LDCs would no longer view large families as necessary for economic survival.

4. *Stronger communities.* Many Radicals, particularly deep ecologists, tend to be as skeptical of government power as they are of markets. As a result, they propose decentralizing substantial political authority to local communities, with regional, national, and global confederations coordinating economic activity.²¹ This economic system could be termed “social anarchism,” indicating that each community is largely independent and as self-sufficient as is economically feasible. Major means of production might be owned collectively by the community and social relations would be highly egalitarian and participatory. Radicals are confident that the experience of belonging to a closely knit community would dampen the desire for material consumption and create greater concern for the community’s natural environment.

5. *Environmental activism.* Radical environmental groups such as Earth First! and Greenpeace engage in acts of civil disobedience and, in some cases, destruction of property to defend nature against industrialization and growth. This activism is designed to raise public awareness of environmental issues and to build groups that will serve as embryonic communities for postcapitalist society.

THE CONSERVATIVE PERSPECTIVE

Causes of Pollution Conservatives believe that nature has much to teach humans about how to structure their social institutions and relations. In nature, Conservatives observe diversity of species, survival of the fittest, the importance of instinct, hierarchical relationships between members of the same species, and homeostasis—the movement toward stable equilibria. Because humans exist as part of nature, these same features should form the basis of society. Conservatives reject “secular humanism,” which makes human purposes the only source of values. Instead, they assert the existence of “natural laws” to which human are morally obliged to conform.

Conservatives share with Radical deep ecologists the view that environmental degradation is linked to the Enlightenment belief that nature exists merely to serve human interests. This “arrogance of humanism” leads to a disregard for the sanctity of nature and the proper place of humans within it. Instead of dominating nature, Conservatives believe that humans have a moral responsibility to practice “stewardship” by living in harmony with nature and minimizing any abuse.²² They view environmental problems as symptoms of the following disorders associated with modern disruptions of traditional societies: 1. *Erosion of hierarchy*. Industrialization and modernization undermined medieval authority and hierarchy organized around church and state. However, once hierarchical power was no longer viewed as natural, humans become dissatisfied with their social status, leading to widespread envy and resentment. In an effort to gain status and self-esteem, individuals in modern societies focus their energies around accumulation of wealth and consumption of commodities. However, seeking self-esteem through possession of material goods is a fruitless quest for most individuals since everyone else is doing the same and only a few will actually become rich. Ultimately, the environment is being sacrificed to high levels of consumption while bringing little meaning or joy to the lives of most citizens.

2. *Decline of religion*. For many conservatives, religion is essential in providing meaning and purpose to human existence while simultaneously curbing passions such as greed, envy, and lust.²³ The 18th-century Enlightenment challenged religious faith by urging humans to use their power of reason to question all existing institutions. Since religion is based on faith, the skeptical attitude associated with modern science has steadily undermined the influence of religion. Humans without religious faith are prone to excessive self-interest, which leads excessive consumption and stress on the environment.

3. *Disintegration of communities*. Conservatives emphasize the importance of closely knit communities in promoting virtuous behavior among members. In communities, we know that others are watching our behavior and any violations of social norms will damage our reputation and

perhaps even restrict our economic opportunities. As the individualism and materialism of modern society erode traditional communities, humans become isolated pleasure seekers, losing most capacities for satisfaction other than the gratification associated with consumption and ownership. Social virtues such as cooperation, honesty, loyalty, and trust are replaced by the pursuit of material gain and individual achievement. For Conservatives, the modern obsession with material goods represents a futile effort to compensate for loss of community by possessing as much of the world as possible.

4. *Capitalism*. While Conservatives today are strong defenders of capitalism, this was not always the case. As capitalism emerged in the 18th and 19th centuries, Conservatives defended the medieval social order based on hierarchical authority and social inequality. They viewed the pursuit of self-interest associated with capitalism as a destabilizing threat to the existing social order and typically aligned themselves with the nobility and aristocracy in opposition to the rising power of merchants and manufacturers. However, after witnessing the horrors of fascism and communism in the 20th century, Conservatives accepted capitalism as the only economic system compatible with individual dignity and social stability. Yet, a lingering skepticism toward capitalism remains. Conservatives worry that capitalism elevates the desire for wealth, immediate gratification, and conspicuous consumption at the expense of social responsibility and ethical behavior. They express concern that the pursuit of self-interest will destroy the foundations of society, including the natural environment, unless strong moral and religious beliefs are maintained.²⁴

5. *Democracy*. Conservatives fear that democracy easily degenerates into struggles for power among interest groups, each pursuing its own narrow goals with little consideration for the public good. Democracy without moral and religious traditions to curb self-interest creates a free-for-all in which everyone seeks greater material benefits through the political process. Politicians must cater to these demands or else face defeat in the

next election. The result of amoral democracy is a society in which collective goals such as preservation of the environment are neglected.

Environmental Policy Despite their concerns about environmental degradation, Conservatives are critical of much of the modern environmental movement backed by Modern Liberals and Radicals. Many Conservatives claim that the political left is using environmental issues as a smokescreen to frighten the public and gain control over government policy. In fact, a common claim among Conservatives is that global climate change is simply part of a naturally recurring cycle unrelated to human activity and, therefore, no cause for alarm.²⁵ They dismiss climate change as a gigantic hoax perpetrated by leftists and climate scientists whose funding for grants depends on exaggerating the threat posed by global warming.²⁶

With their mistrust of democratic governments, Conservatives remain wary of environmental regulations. From the Conservative perspective, the problems with capitalism, democracy, and environmental preservation share the same root causes—the decline of religion and the erosion of civic virtue as evidenced by disintegration of communities, loss of respect for authority, and the dominance of self-interested behavior. Nothing short of moral and spiritual regeneration can fully reverse the trend toward a secular, materialistic society. Like Radicals, Conservatives fear that an environmental catastrophe and the accompanying breakdown in social order may be necessary before humans will change their attitudes.

In the meantime, Conservatives suggest several reforms that might alleviate stress on the environment. Community activities and campaigns to raise awareness about the importance of recycling and conserving energy would be beneficial. Government could make further efforts to promote religion by, for example, funding parochial schools, mandating school prayer, and allowing civic groups to display religious symbols and messages in public locations. In addition, the functioning of democracy could be improved by insulating government from the pressure of interest groups seeking economic gain through the political process. This goal might be accomplished through less frequent elections so that politicians could focus on promoting the public interest rather than catering to special

interests. Ideally, democratic governments should be administered by wise and virtuous leaders who stand above partisan politics. Finally, the functioning of capitalism could be improved by popularizing notions such as corporate responsibility, modesty in consumption, and concern for the well-being of others. These concepts resemble Radical values because both Conservatives and Radicals emphasize the importance of communities in promoting a good society. Healthy communities create a strong sense of identity and belonging, thereby reducing alienation and the obsession with consumption that is so detrimental to the environment.

THE MODERN LIBERAL PERSPECTIVE

Causes of Pollution The first law of thermodynamics states that matter can be neither created nor destroyed, leading Modern Liberals to conclude that maintaining strong rates of economic growth on a planet with finite resources is not feasible. Unless humans colonize other planets or develop hitherto unimagined technologies for harnessing energy and developing synthetic resources, limits to growth are inevitable. Moreover, the effectiveness of recycling is called into question by the second law of thermodynamics, which states that rearranging physical matter reduces its potential for further use.²⁷ Therefore, the long-term viability of human society hinges on protecting the environment. Modern Liberals attribute pollution and depletion of resources to the following failures of the market to allocate resources in a socially optimal manner: 1. *Externalities*. The market generates externalities by establishing prices that fail to reflect the full costs and/or benefits of commodities. For example, the price of steel does not cover the cost of damage created by pollution around a steel mill. Economists at Cambridge University in England first analyzed externalities in the late 19th century. Henry Sidgwick (1838–1900) noted that the market would fail to provide lighthouses because the benefits of a lighthouse can be enjoyed by passing ships without any payment. Therefore, no private owner could charge a price that would reflect those benefits, and

no lighthouses would be built without government funding. Arthur Cecil Pigou (1877–1959) generalized Sidgwick's observation to conclude that markets are inefficient whenever externalities are present. In the case of pollution, the use of air and water as disposal sites creates negative externalities because polluting firms do not pay for waste disposal and affected citizens are not compensated. Polluters have no incentive to reduce emissions because the cost, in terms of damage to the environment, is borne by society as a whole.

2. *Absence of future generations.* Future generations are not present to express their preference for a clean environment, and, therefore, the market consistently undervalues future environmental quality in favor of present consumption and use of resources. Hypothetically, if people of the future could offer to pay for environmental preservation today, the cost of using nature as a source of raw materials and as a disposal site would rise substantially. In other words, the absence of future generations leads to excessive depletion of resources by the current generation.²⁸

3. *Lack of information.* Since consumers often are unaware of the production method used for the goods they purchase, their choice of lower-priced goods does not necessarily indicate a preference for more consumption over environmental protection. Even when consumers and governments do recognize the environmental damage associated with industrial production, they may be ignorant of thresholds beyond which pollution triggers unanticipated and irreversible ecological reactions. For example, we may accept an increase in global temperatures as only a minor inconvenience until a tipping point is reached, climate change accelerates, and sections of the earth become inhospitable to human life. For example, rising sea levels may place major metropolitan areas such as New York City or Miami underwater.

4. *Imperfect competition.* When Classical Liberals claim that the free market is capable of resolving many environmental issues, they are usually assuming that markets are perfectly competitive. Modern Liberals point out that markets frequently contain monopolistic and oligopolistic elements that

cause resources to be diverted from their socially optimal use. For example, corporations may devote resources to lobbying against environmental regulations rather than installing pollution-control devices. Similarly, resources may be devoted to advertising campaigns to persuade the public that an industry poses no threat to the environment rather than developing new technologies to reduce pollution.

5. *Labor mobility*. In a market economy, workers are free to change jobs or locations. Normally, this mobility is a positive aspect of capitalism, but it also poses a potential threat to the environment. Economist Albert O. Hirschman (1915–2012) suggested that individuals facing an undesirable situation such as a polluted neighborhood have the options of “exit, voice, or loyalty.”²⁹ In other words, they can move away from the neighborhood, voice their displeasure through the political process in hopes of changing the situation, or simply endure the status quo. The market encourages exiting by weakening community ties, so citizens are less likely to engage in collective action by seeking political solutions to pollution.

Environmental Policy Most Modern Liberals believe that environmental protection can be compatible with the continuation of capitalism and moderate economic growth.³⁰ However, they view government intervention in the market as essential to preserving the integrity of the environment. Individual citizens and firms possess little incentive to control pollution since doing so usually requires some expense and their individual efforts have little impact. Only government has the capacity to enact regulations binding on all citizens, to collect taxes to fund environmental preservation, and to monitor and enforce environmental laws. Modern Liberals rely on the following policies to protect the environment: 1. *Taxes and subsidies*. Economic theory suggests that greater efficiency can be achieved by taxing negative externalities and subsidizing positive externalities. A tax on pollution equal to the damage imposed on society would discourage pollution, and the revenue could be used to repair the damage and compensate those citizens who are directly harmed. For example, global climate change could be slowed by imposing a “carbon tax” on emissions from burning

fossil fuels. Conversely, since the development and adoption of ecologically sound technologies and products would create positive externalities by protecting the environment, government should subsidize, for example, the development of new technologies for harnessing solar and wind energy, the installation of solar panels, and the purchase of electric automobiles. A second economic rationale for subsidies is to encourage new environmental firms that may not be profitable until they grow to sufficient size to realize economies of scale and thereby bring down production costs.

2. *Regulatory standards.* Unlike Classical Liberals, Modern Liberals support government efforts to control pollution by setting uniform standards for environmental purity. They remain skeptical of the Classical Liberal proposal to auction pollution licenses, insisting that licenses would fail to prevent concentrations of pollution in a specific geographic area. For example, if all the licenses were purchased by Chicago manufacturers, then Chicago would be heavily polluted while other cities enjoyed a cleaner environment. In addition, large corporations have the financial means to afford the cost of pollution licenses, so the responsibility for reducing pollution would fall disproportionately on small businesses. Finally, selling licenses to pollute would give that action the same ethical status as hunting, fishing, driving a car, or getting married. Modern Liberals want to maintain the social stigma attached to pollution by keeping it illegal beyond the level specified by regulatory standards. While environmental regulations do require firms to incur additional costs to control pollution, Modern Liberals argue that spending on environmental protection can improve the economy by creating jobs, stimulating innovation of new environmentally sound products and technologies, and promoting exports of those products.

3. *Product labels.* To overcome the problem associated with consumers' lack of information about how their goods are produced, Modern Liberals favor product labels. In Germany, for example, a "blue eagle" logo is placed on the products of companies meeting stringent environmental standards. Similarly, the "fair trade" label on coffee is intended to assure consumers that coffee beans were grown in accordance with environmental and labor

standards. A current controversy centers around proposals to require that food containing genetically modified organisms be labeled as such.

4. *Sustainable growth.* While Modern Liberals claim that economic growth can be made compatible with environmental protection, they caution that growth must be limited to a level that maintains a sustainable environment.³¹ In 1987, the United Nations' World Commission on Environment and Development formulated the concept of "sustainable development" to assert that economic growth should not exceed levels consistent with the health and well-being of future generations. This highly influential concept has gained support from governments, corporations, and environmental groups around the world. However, the widespread appeal of sustainable development may lie in its ambiguity. How many resources should be left to sustain how many future generations? What standard of living should future generations enjoy? To what extent can technological progress compensate for diminished resources? The concept of sustainable growth provides few answers to these questions and, therefore, offers no specific guidelines for determining what growth rate is compatible with sustainability.

5. *Environmental justice.* The economist Lawrence Summers incited a furor by suggesting that the most efficient way for developed nations to dispose of waste would be to pay LDCs for accepting it. While the LDCs might willingly agree to such an arrangement, the prospect of garbage from the United States, Europe, and Japan piling up in Africa, Asia, and Latin America struck many Modern Liberals as unjust. If the LDCs were not so poor, they would be less likely to accept the use of their nations as garbage dumps. More generally, Modern Liberals seek to formulate environmental policies that do not place an undue burden on the poor.³² For example, a tax on home heating fuel or electricity might be accompanied by a subsidy or rebate for low-income households.

6. *Climate clubs.* Global climate change is proving so difficult to control because each nation has an incentive to be a "free rider," hoping that other nations will incur the costs of controlling carbon emissions. Economist

William Nordhaus proposes that groups of nations form “climate clubs” to engage in cooperative efforts to protect the environment. By agreeing to abide by specific environmental standards and policies, no member of the club would be disadvantaged by higher production costs. A club would use protective tariffs to offset the competitive advantage of nonmember countries failing to conform to the same standards. Over time, nonmembers will seek to join the club in order to avoid the tariffs on their exports.³³

7. *Education.* One of the obstacles to generating more widespread support for environmental protection is the public’s lack of knowledge. Modern Liberals offer two explanations for the substantial portion of the public that either doubts or denies the reality of global climate change. First, they point to a concerted public relations effort by oil, coal, and natural gas companies and their hired scientists to discredit the scientific evidence of climate change and mankind’s role in causing it. But perhaps more important is the human propensity to ignore a potential threat when no solution is apparent. Since contemplating the future devastation that might accompany climate change is discomfiting and individuals feel powerless to respond, they do not want to think about it.³⁴ To counteract both these problems, Modern Liberals favor education, both within schools and for the general public, to raise awareness of the serious potential consequences associated with climate change and other forms of environmental destruction.

8. *Cost–benefit analysis.* Modern Liberals share with Classical Liberals the goal of accomplishing environmental protection in the most efficient manner possible. Economists from both perspectives rely on cost–benefit analysis to assess the costs and benefits of proposed policies and to adopt those policies yielding the greatest net benefits. However, Modern Liberals raise several objections to traditional cost–benefit analysis as practiced by Classical Liberal economists.³⁵ First, in theory, the external benefits of pollution control would be determined by estimating the price that consumers would be willing to pay for a cleaner environment. However, willingness to pay is dependent on one’s income. Low-income families may appear to be indifferent toward a cleaner environment simply because their

lack of money and education causes them to concentrate on more immediate concerns such as food and shelter. A different distribution of wealth and income might dramatically alter the public's willingness to pay for a cleaner environment. In other words, cost–benefit analysis cannot determine the efficient level of pollution without raising questions about the fairness of the distribution of income. Therefore, Modern Liberal economists are more likely to rely on objective measures of the benefits of pollution control such as reduced health risks and increased tourism.

A second caution raised by Modern Liberals concerns the choice of a “social discount rate” to determine the present value of benefits that will occur in the future. Whereas Classical Liberals would attempt to match the social discount rate to the private discount rate of individual citizens, Modern Liberals argue that the future is more highly valued by society as a whole than by individuals. No individual will actually survive to experience the distant future, but society presumably will. While individuals may shirk any responsibility for the well-being of future generations, society cannot ignore this duty without jeopardizing the survival of humanity. Therefore, the social discount rate should be lower than private discount rates so that benefits to future generations are given greater weight in calculations of costs and benefits.

Finally, cost–benefit analysis cannot avoid rather arbitrary decisions concerning the length of time, the geographical area, and the types of costs and benefits to be considered. The longer the time span within which benefits of a cleaner environment are calculated the lower will be the optimal level of pollution by the current generation. Economists can also reduce the optimal level of pollution by including intangible benefits of environmental preservation such as appreciation of the beauty, serenity, and spiritual sustenance gained from wilderness experiences. In the case of global climate change, reducing carbon emissions in any single country may create benefits for every person in the world, so calculations of costs and benefits should be performed on a global scale.

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Chapter 15

International Trade and Development

Globalization has brought issues of international trade and development to the forefront of political economy. New transportation and communication technologies, coupled with reductions in trade barriers, have created an integrated global economy in which resources, products, and information flow freely across national borders. Globalization carries with it the potential for lifting all nations out of poverty and ushering in a new era of peaceful international relations. However, globalization also presents a dark side as national governments lose control over their domestic economies, corporations outsource production and jobs, and conflicts arise as nations struggle over control of resources and cultures clash over fundamental values.

For many of the less developed countries (LDCs), the 1980s were a “lost decade” characterized by slow growth, inflation, and high unemployment. However, the 1990s witnessed impressive comebacks by some countries while others continued to stagnate. Progress during the 21st century has been hampered by the lingering effects of the global financial crisis of 2008. Political economy is particularly well suited to analyze the economies of LDCs since many of the obstacles to development are political and cultural as well as economic.

THE CLASSICAL LIBERAL PERSPECTIVE

Causes of Underdevelopment Classical Liberals believe that economic development will occur naturally if the market is left to operate without interference. They attribute a nation's failure to develop to a combination of the following factors: 1. *Ineffective government*. Classical Liberals call for minimal government (the “night-watchman state”) in both developed and less developed nations. Government can impede development in several ways.¹ First, government can be weak and vulnerable to manipulation by interest groups. A “failed state” becomes incapable of raising sufficient tax revenue to provide the essential prerequisites to economic development such as well-defined and protected property rights, a stable currency, and the rule of law. Countries such as Yemen, Iraq, Syria, Sudan, and Afghanistan are examples of failed states.

Alternatively, government may take the form of a “predatory state” or “transfer state” used by some groups to extract wealth from the rest of the population. In a predatory state, many government officials are corrupt and the power of government is focused on the enrichment of elite groups rather than economic development of the nation. Substantial resources may be devoted to nonproductive purposes such as monuments to glorify political leaders or large military and police forces to suppress dissent. Government officials and their allies in the private sector funnel money from the public treasury to private estates, personal investments abroad, and purchases of imported luxury goods.

Even a well-intentioned government can block economic progress by acting as a “developmental state” with conscious strategies to promote rapid growth. Classical Liberals believe that government intervention only impedes the market's ability to foster economic development. Although the market may exhibit certain “failures” such as externalities and an inability to provide public goods, government failures are even more detrimental to the economy. For example, the wider the extent of government intervention, the greater the incentive for interest groups to engage in “rent-seeking” to manipulate the intervention for their own benefit. Also, larger government bureaucracies lead to increased waste and corruption. Classical Liberals are so confident in the ability of free markets to spur development that they

reject virtually all policies relying on planned strategies by government and development experts.²

Their mistrust of politics places Classical Liberals in an awkward position with regard to democracy in LDCs. During much of the 20th century, they remained silent about abuses of civil and human rights by authoritarian governments in noncommunist nations. In the mid-1970s, Milton Friedman (1912–2006) and other economists from the University of Chicago served as advisors to the military junta that overthrew the democratically elected president in Chile. They viewed the authoritarian rule of the junta in Chile as a necessary stage to suppress conflict, create investor confidence, and forge a national consensus in favor of capitalism. Classical Liberals proudly note that Chile is now one of the most prosperous and democratic nations in Latin America.

2. *Foreign aid.* Classical Liberals oppose foreign aid for the same reasons they oppose welfare programs within nations. Aid undermines self-reliance and initiative in LDCs and fosters dependency on the generosity of developed nations. Aid in the form of food cripples farmers in LDCs by suppressing agricultural prices. In some cases, receiving the aid may require travel to a distribution center, which takes time away from productive activity. Viewed from a worldwide perspective, Classical Liberals claim that foreign aid slows the engines of the global economy by diverting resources from their most productive use. The most effective way to help the LDCs is to promote economic growth, and free markets are more effective than aid in accomplishing that goal.³

3. *Trade protectionism.* Many LDCs have sought to preserve national autonomy and protect domestic producers by enacting tariffs, quotas, capital controls, and other barriers to the free flow of goods and resources across borders. To demonstrate the harm done by protectionism, Classical Liberals rely on the theory of comparative advantage developed by English economist David Ricardo in the early 19th century. A nation has comparative advantage when it can produce certain goods with relatively greater efficiency than another country. In theory, if countries specialize in producing those goods in which they have comparative advantage and then

trade with other countries, global production will increase and all countries will enjoy a higher standard of living.⁴ From the Classical Liberal perspective, protective trade barriers harm the economy by preventing resources from flowing to their most productive use, by shielding firms from market pressures to reduce costs and innovate, and by encouraging rent seeking as firms devote resources to lobbying efforts to secure protection against foreign competition.

4. *Communal culture.* The cultures of many LDCs continue to reflect past traditions such as tribal customs, extended family structures, and other communal systems that enmesh individuals in a web of both support and responsibilities. From the Classical Liberal perspective, these social networks impede individual ambition and entrepreneurship. Individuals who seek opportunities outside the community risk losing their support system, and if they are successful, family and community members expect to share in the good fortune. By increasing the risk and reducing the individual benefits of entrepreneurship, a communal culture discourages growth and development.

5. *Lack of resources.* A nation's lack of resources is often the most obvious cause of underdevelopment. Countries such as Tunisia and Algeria consist mostly of the Sahara desert and remain largely underdeveloped. Conversely, the most developed nations tend to be located in the temperate regions of the globe where hardwood forests, deposits of iron ore and coal, and navigable rivers are found. In the past, the role of resources in determining development seemed so obvious that some economists proposed the concept of "geographical determinism" in which a country's economic fate is sealed by the quality of its climate, topography, and endowments of natural resources. However, globalization has dramatically reduced the significance of resource endowments. According to Classical Liberals, if a country allows the free flow of resources across its borders, whatever resources are needed can be purchased from elsewhere. South Korea stands out as a notable example of a country that has compensated for a lack of natural resources to become one of the strongest economies in the world.

Development Policy Classical Liberal policies on trade and development date back to Adam Smith and David Ricardo, but modern formulations were pioneered by economists such as Jacob Viner (1892–1970), Harry Johnson (1923–1977), Gottfried Haberler (1900–1995), and Peter Bauer (1915–2002). From the Classical Liberal perspective, the same economic principles apply to both developed and developing countries. Free trade and competitive markets are the optimal strategies for raising standards of living anywhere in the world. The market, with its strong incentives for increasing the quantity and quality of economic resources, is the key to mobilizing a nation for economic development. If left free from interference by social, political, or cultural forces, the market will spontaneously generate growth.

Classical Liberals are so confident of free trade that they urge countries to drop all trade barriers even if trading partners continue to practice protection. Free trade permits a country to obtain goods at lower prices, and the fact that other countries have restrictions on trade does not alter the positive effects of less expensive imports. Since all trade is voluntary, a country cannot harm itself by expanding its opportunities to buy from foreigners. To overcome the reluctance of some nations to drop their trade barriers, Classical Liberals advocate international trade agreements, in which a group of countries commit themselves to free trade. Examples of such agreements include the North American Free Trade Agreement (NAFTA) and the European Union.

While touting the long-term benefits of free trade and free markets, Classical Liberals acknowledge that the transition from a traditional, agrarian society to a market economy is inevitably a wrenching experience as traditional jobs are lost, inefficient industries disappear, and cultures are transformed. But free trade hastens the development process by shifting peasants out of subsistence farming and into factories where, through increased productivity, their standards of living can rise. Food can either be imported or produced by more efficient, large-scale agribusinesses. Untapped natural resources will be transformed into productive inputs once the exposure to global markets makes their extraction profitable. The emergence of merchants and entrepreneurs not only breaks the grip of traditional elites on political power but also forms a wealthy class. From the

Classical Liberal perspective, inequality in the distribution of wealth and income is essential to promote savings that will provide the funds for investment and growth.

The Classical Liberal view of the development process is sometimes called “diffusion.” In the absence of barriers to trade and political intervention in domestic markets, capitalism and prosperity will naturally spread to all countries. Multinational corporations play an important role in diffusion as they provide jobs, capital, vocational training, tax revenue, and, in some cases, transportation systems and other infrastructure. They also spread values and lifestyles conducive to growth such as entrepreneurship, individual achievement, and consumerism.

In response to concerns that globalization, free trade, and multinational corporations will harm workers in the industrialized nations, Classical Liberals emphasize the following advantages of free trade:

- Increased consumption as each country specializes in producing what it does best.
- Greater efficiency and innovation and less inflation due to competitive pressure from firms in other countries.
- Wider range of consumer choice among goods produced all over the world.
- Improved international relations due to each country’s interest in continuing trade.
- Cross-fertilization of technologies, cultures, and ideas as countries become more interdependent.
- Development of LDCs as they gain wider markets for their exports and access to the technology, resources, and consumer goods offered by industrialized nations.

To explain popular opposition to free trade, Classical Liberals make two points. First, the general public is not aware of the theory of comparative advantage and, therefore, focuses on the loss of some industries while failing to appreciate that free trade creates opportunities for expansion in other industries. Second, the benefits of free trade are long term and dispersed across the entire population, while the losses are immediately visible and concentrated in particular industries, occupations, or regions.

Therefore, groups temporarily harmed by free trade are more likely to organize to demand protective legislation while the majority of citizens remain passive. Politicians sense that providing protection will gain votes from the citizens harmed by free trade without losing votes among other groups.

Finally, despite their hostility toward most government programs, some Classical Liberals such as Friedrich Hayek have proposed an international governing body to assure that all countries establish and enforce the basic prerequisites for a market economy, including well-defined and protected property rights, enforcement of contracts, and protection of patents.⁵ Trade agreements such as NAFTA and the Trans-Pacific Partnership attempt to accomplish this purpose on a regional scale.

THE RADICAL PERSPECTIVE

Causes of Underdevelopment Radicals propose two distinct and even contradictory explanations for the failure of some countries to develop. The first, despite its origins in the writings of Karl Marx, is nearly identical to the diffusion theory of Classical Liberalism. In *The Communist Manifesto*, Marx and Engels praised capitalism for accomplishing the historically necessary task of mobilizing resources and destroying traditional social and political institutions to pave the way for modernization. Marx had little sympathy for romantic visions of traditional culture, claiming that capitalism had rescued “a considerable part of the population from the idiocy of rural life.” He anticipated that capitalism, by stimulating innovation and cost cutting, would create the industrialization necessary for communism. So Marx was just as supportive of capitalism as were Classical Liberals. Marx envisioned a future beyond capitalism, but for the present, capitalism had an historical task to perform in laying the industrial groundwork for socialism and ultimately communism.

This Radical version of capitalism’s ability to spread throughout the world and lift countries out of their feudal and tribal pasts leads to some surprising conclusions. Radicals who accept diffusion tend to support

globalization and multinational corporations for spreading capitalism beyond the currently industrialized countries. They encourage LDCs to open themselves to foreign trade and investment in order to gain the capital and technology required for development.

Marx observed that the economic systems of some countries were less conducive than others to capitalist development. In particular, he attributed the lack of industrialization in Asia to the need for large-scale irrigation projects that required extensive political authority to mobilize resources. The power of government suppressed the entrepreneurial and commercial activity essential to the rise of capitalism. Marx labeled such systems “oriental despotism” or the “Asiatic mode of production,” and his analysis may explain the late entrance of China into the global economy. The view that capitalism is ultimately beneficial to LDCs does not deny that competitive international markets may wreak havoc on traditional economies and social structures, but this disruption is regarded as necessary to achieve the rising standards of living that accompany capitalism.

If economic development in LDCs depends on the diffusion of capitalism, then the failure to develop is caused by lack of exposure to and integration into the global capitalist system. In the early stages of capitalism, underdevelopment might be explained simply by the fact that not enough time had passed for capitalism to spread throughout the world. Today, however, capital flows wherever profitable opportunities appear, so a failure to develop can be explained by a government’s hostility toward capitalism, which leads to protectionist policies that interfere with the flow of resources and goods.⁶

A second Radical approach to underdevelopment is called “dependency theory.” Its analysis and conclusions are diametrically opposed to the concept of diffusion. In Marx’s later writings, he argued that the continued accumulation of capital in the developed countries requires an underdeveloped “periphery” of nations to serve as markets for excess goods, sources of cheap raw materials, and profitable investment opportunities. In other words, capitalism in one part of the world thrives when other parts of the world remain underdeveloped. To illustrate this point, Marx described the 19th-century British tactic in India of smashing

handlooms and cutting off the thumbs of weavers to assure India's continued reliance on British textiles.

Historical roots of dependency theory can also be found in the writings of Lenin.⁷ He argued that foreign investors were taking advantage of cheap labor in Russia to gain high profits with which they could quell revolutionary discontent by paying higher wages to workers in the industrialized countries. Lenin claimed that workers in Europe and North America had become an "aristocracy of labor," whose privileged position explained their lack of revolutionary fervor. Whereas Marx had predicted that socialist revolution would begin in the most industrialized countries, Lenin concluded that Russia, as the "weakest link" in the capitalist chain, must initiate the revolution.

The assertion that development in the industrialized countries retards development elsewhere has gained increasing acceptance among Radicals. Paul Baran (1926–2011) argued that development throughout the world was blocked by the trade and investment practices of developed capitalist countries.⁸ He claimed that foreign investors formed political alliances with feudal landowners in LDCs, resulting in authoritarian governments opposed to labor unions, civil rights, and democracy. Baran also claimed that trade with industrialized countries drains wealth from the LDCs as imported goods hurt their domestic industries and their domestic agriculture is converted to commercial crops grown for export.

The actual term "dependency theory" appeared during the 1960s and 1970s in the works of Latin American economists Celso Furtado (1920–2004), Osvaldo Sunkel, and Theotonio dos Santos.⁹ Variants of dependency theory are found in the theory of "unequal exchange" formulated by Samir Amin and Arghiri Emmanuel (1911–2001) and the "world systems theory" of Immanuel Wallerstein. According to these theorists, the primary problem confronting LDCs is not lack of foreign trade and investment, but rather exposure to and involvement with global capitalism.¹⁰

Dependency theorists trace the origins of underdevelopment to the 15th and 16th centuries when European nations began colonizing distant lands to obtain precious metals and other resources. European colonialism destabilized indigenous social and economic institutions, subverting their capacity for independent development. Europeans installed or protected

local rulers who were receptive to foreign interests, and Europeans themselves populated the LDCs as government officials and as owners of plantations and factories. They concentrated development on a few industries such as mining, timber, agriculture, or rubber, making LDCs vulnerable to changing patterns of international demand. Moreover, profits were often either repatriated to Europe or used for consumption of imported luxury goods. This system of “peripheral capitalism” caused economic development in LDCs to stall, as both foreign and domestic elites used profits to protect themselves from challenges to their power and privilege.

To test the claims of dependency theory, economist Andre Gunder Frank (1929–2005) examined the historical relationship between rates of growth in the LDCs and the degree of economic interaction between LDCs and industrialized countries. He found that LDCs experienced some of the highest growth rates during periods when the industrialized countries were absorbed in war or depression and therefore trading less. Conversely, during times of peace and prosperity, when trade and investment activities were greatest, LDCs fared relatively poorly.¹¹ These findings challenge both the Classical Liberal and the Radical views that capitalism results in a diffusion of development throughout the world.

Development Policy Radical policies for promoting economic development reflect the schism between diffusion and dependency theories. According to the diffusion view, capitalism is a progressive force in global development, so the business class in LDCs should be supported in its efforts to overthrow feudal oligarchies and modernize government and culture. Revolutionary movements by peasants and workers are discouraged because LDCs have not yet achieved the industrial base needed to transcend capitalism. For example, the Soviet Union was initially reluctant to support Fidel Castro’s efforts to overthrow the Batista regime in Cuba because capitalism had not yet accomplished its historical task of industrializing that nation. Similarly, in 1968, when a general labor strike and subsequent riots placed France on the brink of revolution, the Soviet Union instructed members of the French Communist Party to return to work because even industrialized France was not yet fully prepared for socialism.

In sharp contrast, dependency theorists encourage LDCs to minimize contact with the industrialized countries in order to develop independently. Because nations need to trade for certain resources, dependency theorists advocate “collective self-reliance,” in which groups of LDCs trade primarily with one another. This idea materialized with the 1962 formation of the Latin American Free Trade Association among seven Latin American countries. According to dependency theorists, national independence is important for psychological as well as economic reasons. Exposure to the lifestyles and consumption patterns of the industrialized countries tends to alienate citizens of LDCs from their own cultures and creates a sense of inferiority. Restoring national pride releases the productive energies of citizens currently constrained by their own feelings of powerlessness.

The influence of dependency theory was demonstrated in the choice of many LDCs during the 1950s and 1960s to pursue a development policy known as “import substitution industrialization” (ISI). Tariffs were placed on imports to protect “infant industries” in the LDCs against competition from more advanced industries in the developed countries. Governments would often subsidize or nationalize these industries in order to promote their expansion. Other policy proposals from dependency theorists include a reorientation of agriculture away from production for export and toward meeting the needs of local citizens, the use of labor-intensive or small-scale technology in order to increase employment, and public investment in infrastructure.

In practice, the results of ISI were usually disappointing. Protective tariffs and subsidies removed competitive pressures on firms in LDCs to innovate and become more efficient. By making essential imports more expensive, tariffs also contributed to inflation. Toward the end of the 20th century, nearly all LDCs were moving in the direction of free trade and openness to foreign investment. India, for example, made a dramatic shift toward free trade in the early 1990s, Mexico agreed to the NAFTA in 1992, and two separate free trade agreements are currently being negotiated—the Free Trade Area of the Americas encompassing 34 nations and the Trans-Pacific Partnership with 12 nations.

Radicals remain ambivalent about free trade.¹² The lingering influence of dependency theory continues to raise concerns about the effects of free

trade on LDCs, but Radicals also condemn many protectionist policies for simply preserving the privileges of domestic elites in LDCs. This same ambiguity extends to Radical debates over free trade policies for industrialized nations. On one hand, some Radicals view free trade as undermining the bargaining power and standards of living of workers in developed nations. Yet, protectionist policies would reduce export markets for LDCs and potentially harm workers in those nations. This conundrum is only one part of the broader Radical interpretation of globalization.¹³

From the Radical perspective, the process of globalization is simply the geographical extension of capitalism as every part of the world becomes integrated into a single market. Diffusion theorists welcome this process as preparing all nations to make the transition to a postcapitalist society in cooperation with each other. Dependency theorists remain skeptical, arguing that severe dislocations will arise as the market functions in the near absence of any international regulatory agencies. They predict increasing global inequality, environmental destruction, instability, and conflicts erupting through war and terrorism. Both sides of the debate agree, however, that harnessing the positive effects of globalization and minimizing its limitations will require new forms of global governance. Capitalism has rendered national sovereignty partially obsolete, and mankind must now act collectively to construct new global institutions in order to secure a positive future.

THE CONSERVATIVE PERSPECTIVE

Causes of Underdevelopment Conservatives have not devoted much attention to the issues of international trade and development. Given their dissatisfaction with the course of development in the West, they remain skeptical about efforts to introduce the same kind of development to LDCs. Economic development in the West brought disintegration of traditional communities, a decline of traditional authority, and the emergence of a rootless, mobile population focused primarily on the pleasures of consumption and entertainment. Conservatives attribute many of the social ills of modern societies to the hubris and

overconfidence spawned by the Enlightenment belief that human reason is capable of improving societies by fundamentally restructuring institutions. From the Conservative perspective, each society is based on unique social practices that have evolved over centuries. Attempts to reform social institutions are more likely to disrupt and damage societies rather than promote development.

Conservatives believe that capitalism functions best when elements of precapitalist cultures are maintained. LDCs typically exhibit precapitalist values such as loyalty and obligation to one's community, deference to authority, enjoyment of collective activities such as religious celebrations, and a commitment to ethical behavior. Conservatives suggest that once adequate levels of nutrition and health care have been achieved, individuals in LDCs may be happier than citizens of industrialized countries because their lives remain rooted in family, community, and religion instead of consumption and the pursuit of wealth.

However, acknowledging that citizens in many countries have not yet achieved an adequate material standard of living, Conservatives offer the following explanations for underdevelopment: 1. *Culture*. While Conservatives highlight the importance of communities in providing their members with support and meaning in their lives, social ties among closely knit tribes and extended families can be so strong that individuals fail to develop an "achievement orientation" to distinguish themselves from their social group.¹⁴ As a result, individuals lack the ability to initiate new ideas, take risks, and start businesses. Life in LDCs tends to be unchanging as individuals seek harmony with their group and with nature. When people regard themselves primarily as members of a group rather than as individuals, they are less adept at the rational, calculating mentality essential to success in a market economy. They are less likely to delay gratification by saving and investing and also prone to uncontrolled reproduction. Finally, people in LDCs often exhibit a preindustrial attitude toward time, making it difficult for them to conform to schedules and therefore unprepared to work in an industrialized economy.

2. *Environment*. Conservatives suggest that one reason for early economic development in Europe and North America was the need to

produce an economic surplus in order to survive through adverse weather conditions and cold seasons. A harsh environment forced citizens to be energetic and innovative. In contrast, many of the LDCs are located near the equator where heat and humidity make strenuous physical activity very difficult. In addition, tropical climates tend to have abundant supplies of nuts and fruit, so people are rarely forced to plan for the future or organize themselves to control their environment.¹⁵ Instead, they devote their time to leisure, recreation, religious rituals, and community social life. Conservatives claim that when workers in LDCs have no aspirations beyond meeting their basic needs, they do not respond to monetary incentives. For example, if an employer offers higher wages, workers may show up for work less often because they can now meet their basic needs with fewer hours of work. This response leads to a “backward-bending” supply curve of labor, suggesting that wages should be kept low in LDCs in order to motivate greater work effort.

3. *Imperialism*. During the early 19th century, Conservatives supported cultural and religious excursions into Africa, Asia, and Latin America. The notion of the “white man’s burden” obligated European and North American Christians to impose their religious systems on native cultures. However, by the late 19th century, missionary work evolved into imperialism as merchants and manufacturers from industrialized countries sought cheap resources and markets for their goods in LDCs. At that time, Conservatism was the ideology of the landed aristocracy whose power and wealth were being challenged by the rising business class. As a result, Conservatives became critical of imperialism, claiming that it not only disrupted traditional cultures in the colonies but also imposed huge costs on the governments of industrialized nations as they were forced to engage in continual warfare to subdue revolts and rebellions. By the early 20th century, this opposition to imperialism led Conservatives to adopt an isolationist stance toward all government involvement in foreign nations.

4. *Democracy*. Even after gaining independence from European colonialism, many LDCs were ill-prepared for economic development. Efforts to adopt democracy often ended in chaos as no political party could

gain a sufficient majority of votes to rule effectively. In many LDCs, ethnic and religious strife made political leaders from any particular group unacceptable to members of other groups. Conservatives point to India as evidence that democracy is unsuitable for promoting the early stages of economic development. India began its independence from British rule in 1948 with a healthy democratic political system and yet failed for decades to make significant economic progress. In contrast, countries such as South Korea, Singapore, and Brazil had long periods of authoritarian rule and today enjoy substantial prosperity.

Development Policy Conservative views on appropriate policies for fostering development have evolved over the past century. During the early 20th century, Conservatives remained largely isolationist, and many were opposed to U.S. involvement in World War II (WWII). However, the threat of communist expansion following the war caused a reassessment of isolationism. Poverty and hunger could provide fertile breeding grounds for the spread of communism, so Conservatives acknowledged a responsibility for the industrialized nations to engage in efforts to improve conditions in the LDCs.

1. *Support for authoritarian governments.* Given their belief that LDCs are not yet ready for full democracy, Conservatives have encouraged efforts by the governments of industrialized nations to support governments in LDCs. In determining which governments deserve support, Conservatives distinguish between “authoritarian” and “totalitarian” regimes.¹⁶ The former may suppress democracy and civil rights, but they protect private property, encourage foreign investment, and preserve the existing social hierarchy. Totalitarian regimes, conversely, are socialist and communist governments that threaten property rights demonstrate hostility toward capitalist nations and discourage foreign investment. Conservatives favor efforts to overthrow socialist governments as happened when the Central Intelligence Agency (CIA) planned the ouster of President Salvador Allende in Chile in 1973 and funded the training of armed forces to defeat the Sandinista government in Nicaragua in 1987. In contrast, Conservatives have consistently supported aid to authoritarian governments in the form of

military weaponry, training of police and armies, and launching covert operations to undermine leftist political parties. Although authoritarian governments are prone to violations of civil rights, including murder and torture, Conservatives tolerate such abuses as necessary to rid LDCs of socialist elements and to orient these countries toward capitalist development. Once political stability has been achieved and development becomes self-sustaining, free and open elections can be held.

As the threat of communism and socialism virtually disappeared toward the end of the 20th century, the rise of Islamic fundamentalism provided the rationale for continued support for authoritarian governments in Middle Eastern countries such as Saudi Arabia, Syria, Bahrain, and Qatar. Until he invaded Kuwait in 1990, even the Iraqi dictator Saddam Hussein was viewed by Conservatives as a useful ally in maintaining stability in the Middle East.

2. *Limited foreign aid.* Conservatives are skeptical of the benefits of humanitarian aid from governments of developed nations. They argue that any positive effects of such aid may be offset by explosive population growth and a flood of “rising expectations” leading to social disorder. A common Conservative argument against providing foreign aid is that “we should take care of our own” before worrying about the welfare of people in other nations. In contrast, individual Conservatives with deep religious convictions may feel a moral obligation to assist impoverished people in other countries.

3. *Hegemony.* A nation has global hegemony when it is sufficiently powerful to deter any challenges by other nations. Conservatives believe that hegemony maintains peace and order by preventing conflict between nations. In a world without hegemonic power, countries would continually attempt to encroach on their neighbors’ territory, resulting in armed conflicts and even wars. After WWII, Conservatives anticipated that the United States would be the global hegemon, but the military strength of the Soviet Union, coupled with its development of nuclear weapons, forced Conservatives to accept a dual hegemony, in which the United States

maintained order in the West and the Soviet Union did the same in the East.¹⁷

4. *Protectionism.* Conservatives have historically favored protective trade barriers. In the late 19th century, Germany's industrial revolution occurred nearly a century after British industrialization. Chancellor Otto von Bismarck established high tariffs on foreign imports to protect Germany's "infant industries" from competition with more mature British industries. The same logic can be applied to LDCs in which new businesses have neither the size nor the experience to compete freely with firms in the industrialized nations. Protective tariffs can insulate them from competitive pressures until they gain sufficient size and expertise to match the efficiency of foreign firms.

Some conservatives oppose free trade for the developed nations as well.¹⁸ They argue that without protection, firms face competition from businesses in LDCs with lower costs due to lower wages, fewer government regulations, and lower taxes. This competition will either pull wages down in the developed nations or force companies to relocate or outsource much of their production to LDCs. Conservatives are not willing to let the manufacturing sector of the industrial economies move overseas. They note that both the United States and Germany enacted high tariffs during the 19th century and yet quickly surpassed Britain, the country most devoted to free trade at that time.

THE MODERN LIBERAL PERSPECTIVE

Causes of Underdevelopment In the aftermath of WWII, Modern Liberals were concerned that the rapid transformation of the Soviet Union into a global power might provide an appealing model of development for LDCs throughout the world. This concern was heightened when the Soviet Union retained control of Eastern Europe and installed communist regimes in those countries. In 1949, communists gained control of China, and in the early 1950s, they

successfully resisted U.S. efforts to defeat them in North Korea. Even countries such as India and Egypt began aligning themselves more closely with the Soviet Union than with the United States. Modern Liberals concluded that the most effective protection against the spread of communism was rapid economic development of the LDCs to eliminate the hunger and misery that drive people to political extremes. The academic field of development economics was dominated by Modern Liberals, including Gunnar Myrdal (1898–1987), Paul Rosenstein-Rodan (1902–1985), Ragnar Nurkse (1907–1959), Raul Prebisch (1901–1985), William Arthur Lewis (1911–1991), and Albert O. Hirschman (1915–2012). Like Classical Liberals, Modern Liberals acknowledge the need to mobilize resources in LDCs and to instill values such as individual initiative and entrepreneurship. However, Modern Liberals also validate the Radical view of colonialism and imperialism as significant factors in blocking development. They propose that governments in both the industrialized countries and the LDCs should pursue active policies to address past injustices and hasten the development process.

Modern Liberals point to the following causes of the inability of many LDCs to thrive: 1. *Underdeveloped markets*. Markets in LDCs either fail to materialize or else function poorly for reasons such as lack of information, mistrust, immobile resources, high transaction costs, lack of infrastructure such as transportation and communication systems, and ill-defined property rights. Moreover, behavioral traits such as risk taking, individual initiative, and entrepreneurship often lie dormant.

2. *Ineffective government*. As imperialist powers colonized Africa, Asia, and Latin America, they often installed puppet governments to give the appearance of local rule. These governments were subservient to the mother country and directly controlled by a relatively small number of wealthy families who formed mutually beneficial coalitions with the colonizers. As increasing numbers of LDCs gained independence after WWII, their new governments reflected the legacy of imperialism. Political leaders often viewed themselves as entitled to the same power and privileges enjoyed by their colonial predecessors. They diverted resources to build monuments to

glorify themselves and the state, established large armies, and engaged in display of wealth and status. To maintain their base of political support, these governments used public resources to benefit favored groups rather than promoting development for the entire population. Governments in many LDCs were more committed to preserving the existing power structure than to economic development.

3. *Extreme inequality.* In many LDCs, the legacies of feudalism and colonialism remain in force. The concentration of wealth and income keeps a large portion of the population in poverty. Laborers toil for long hours with little pay and few opportunities for advancement. This extreme inequality poses an inherent obstacle to development. Economist Richard Nelson coined the term “low-level equilibrium trap” to describe a country’s inability to generate sufficient saving and investment for growth because most citizens spend their entire income simply to survive.¹⁹ Wealthy families that could potentially provide investment funds often divert their wealth abroad due to lack of domestic consumer demand. Also, they are subject to a “demonstration effect” as they display their status by emulating consumption patterns in the developed countries. As a result, financial resources that could have been channeled into capital formation in the LDCs are instead used to purchase imported luxury goods or deposited in foreign banks and stock markets.

According to Modern Liberals, inequality creates other perverse effects on the economies of the LDCs. With production geared toward manufacturing luxury goods for the wealthy rather than food, clothing, and shelter for the bulk of the population, the markets for basic necessities remain small and inefficient. Poverty prevents farmers from experimenting with new agricultural techniques because a single crop failure could mean starvation. Poverty also causes overpopulation because parents view children as additional workers to help support the family. Finally, the development of human resources is blocked when families cannot afford adequate nutrition, health care, and education.

4. *Free trade.* While Modern Liberals acknowledge that international trade between similarly developed nations can be mutually beneficial, they

believe that free trade may potentially harm LDCs. Swedish economist Gunnar Myrdal claimed that free international trade operates to the advantage of the developed countries and perpetuates stagnation in the LDCs.²⁰ This claim was subsequently elaborated by Raul Prebisch and Hans Singer (1910–2006). Relying on an economic principle known as Engel's Law, which states that the percentage of income spent on food becomes smaller as GDP rises, Prebisch and Singer concluded that demand for the agricultural exports of LDCs would fail to keep pace with rising incomes in the industrialized countries. As a result, prices of LDC exports would drop relative to prices of manufactured goods imported from developed nations. In addition, the market power of corporations and labor unions in the developed countries pushes the prices of manufactured goods up, while the largely nonunionized workers and smaller businesses in the LDCs possess little control over the prices of their exports.

Development Policy In the aftermath of WWII, the United States initiated the Marshall Plan to rebuild war-torn Europe. The success of that effort persuaded many economists that government had an essential role to play in promoting economic development.²¹ By the 1950s, economists turned their attention to the LDCs, formulating a variety of policies to stimulate economic growth. Both Ragnar Nurkse and Paul Rosenstein-Rodan advocated “balanced growth,” in which governments in LDCs would stimulate a wide variety of industries simultaneously so that growth in each industry would support growth in the others.²² Rosenstein-Rodan called this effort a “big push” to get the entire economy moving toward self-sustaining growth. According to Nurkse, growth could not be dependent on exports since the “infant industries” in the LDCs could not compete with mature firms abroad. Instead, he called for “import substitution industrialization” (ISI) in which government would protect, subsidize, and perhaps even own industries producing previously imported goods.

Other Modern Liberal economists were skeptical of the concept of balanced growth. Albert Hirschman doubted that governments in LDCs could obtain sufficient funds from abroad to finance such efforts and advised them to target their limited funds on a few select projects with

linkages that would spur other industries throughout the economy. For example, building a dam to generate cheap electricity might spur development of manufacturing in the region.²³ Arthur Lewis proposed that stimulus should be limited to urban manufacturing in order to entice people to leave rural areas and move to cities where their labor would be more productive.

Many of these early Modern Liberal development strategies, particularly ISI, have been abandoned due to disappointing results. In fact, the 1980s witnessed a “counterrevolution” in development economics as Classical Liberals made renewed defenses of free markets in LDCs. However, Modern Liberals have responded with a variety of revised policies for trade and development.

1. *Growth with equity.* Modern Liberal economists distinguish between “growth” and “development.” Economic growth, meaning a rising GDP, may occur simply because the rich are getting richer while the rest of the population languishes in poverty. For Modern Liberals, development requires not just a rising GDP but also substantial improvements in the lives of average citizens through improved education, health care, and standards of living. As noted by Simon Kuznets (1901–1985), the early stages of growth are typically accompanied by increasing inequality and a worsening of conditions for the poorest members of society due to the decline of the agricultural sector relative to the manufacturing sector.²⁴ To counteract this trend, Modern Liberals call for “growth with equity” by focusing development efforts on social goals such as reducing infant mortality, raising the literacy rate, and meeting the basic needs of the population.²⁵ This “bottom-up” approach relies heavily on participation by local citizens in learning new techniques and practices for agriculture, public health, education, and community organization. To promote development at the local level, British economist E.F. Schumacher (1911–1977) insisted that new projects such as irrigation systems should use “intermediate technology” lying somewhere between the capital-intensive techniques of the industrialized countries and the traditional labor-intensive techniques of the LDCs.²⁶ Otherwise, these projects are likely to exacerbate unemployment by reducing the amount of labor required for production.

Another aspect of “growth with equity” is land reform. In many LDCs, ownership of land is concentrated in the hands of a relatively few wealthy families, and the land is primarily used for export crops. As a result, peasants are often denied access to land and must migrate to urban areas where poverty persists. Modern Liberals advocate government efforts to disperse the ownership of land by breaking up large estates into smaller peasant holdings. Because wealthy families exert considerable political pressure on local governments to block land reform, Modern Liberals have suggested that foreign aid be contingent on significant progress in land reform.

2. *Creating capabilities.* In response to disappointment with top-down strategies initiated by planners and bureaucrats, Modern Liberals have adopted the phrase “putting people first.” This strategy goes a step beyond “growth with equity” by claiming that a prerequisite for growth is healthy, energetic citizens freed from bonds of servitude and dependence. Once individuals gain self-esteem and opportunities to advance, growth will ensue. To create an energized and capable citizenry, development efforts should focus on education, health care, nutrition, adequate housing, and community efforts to initiate business activities.²⁷

3. *Fair trade.* The goods exported by LDCs are sometimes low priced because producers pay subsistence wages, freely dispose of manufacturing waste in the air or water, or operate with unsafe working conditions. To remove any incentive to reduce production costs by exploiting workers or damaging the environment, Modern Liberals propose several policies. First, product labels can be attached to those goods produced without exploiting workers or damaging the environment so that consumers can choose to buy from socially responsible firms. Second, an international agency could impose tariffs equal to the reduction in costs gained through socially irresponsible business practices. Finally, if one country subsidizes industries in order to gain a competitive advantage, fair trade might call for matching subsidies in other countries in order to maintain a level playing field.²⁸

4. *Strategic trade*. Modern Liberals chart a middle course between free trade and protectionism. Free trade, they argue, undermines the ability of both developed nations and LDCs to achieve certain domestic goals such as higher wages, a cleaner environment, or the formation of new industries. When free trade prevails, competitive market pressures compel nations to reduce environmental protection, weaken labor unions, and cut taxes in an effort to attract new businesses and retain existing firms. For smaller LDCs, free trade can result in specialization in just a few industries, rendering them vulnerable to changing technology or consumer tastes. Keynes himself favored a degree of protectionism so that international competition would not drive down wages to the point where workers had insufficient purchasing power to sustain aggregate demand.²⁹

Modern Liberal economists such as Paul Krugman, John Culbertson (1921–2001), and Robert Kuttner have formulated “strategic trade theory” to provide rationales for government intervention in international trade.³⁰ They argue that governments can create comparative advantage through a combination of protectionism and stimulus to selected industries. For example, the Japanese automobile industry would never have become a global powerhouse without initial protection and funding from the Japanese government.

The idea that comparative advantage can be created by government casts an entirely different light on trade policy. Rather than accepting whatever comparative advantage its climate and natural resources provide, a country can, to some extent, make conscious choices about the industries in which it will specialize. For example, increased funding for technical education can pave the way for specialization in high-tech industries by providing a proficient workforce. Countries with highly skilled labor forces and innovative entrepreneurs will dominate the profitable industries of the future. In summary, “strategic trade” involves not just mild protection and subsidies to select industries but also the intentional creation of the infrastructure and resources needed for success in those industries.

5. *Trade agreements*. Modern Liberals acknowledge that protectionism can degenerate into trade wars as one country responds to another country’s trade barriers by erecting even higher ones. Moreover, despite their doubts

about free trade, Modern Liberals affirm the potential benefits of specialization and trade. They realize that politicians are pressured to oppose free trade by industries lacking comparative advantage and by voters who are harmed by closed factories and lost jobs. To create popular support for reducing trade barriers, Modern Liberals favor multilateral trade agreements in which a group of countries agree to make concessions, allowing more open access to one another's markets. However, certain details of trade pacts such as the Trans-Pacific Partnership have aroused opposition from Modern Liberals who argue that the agreements place greater priority on protecting corporations from patent violations and government regulation than on promoting economic development. Some Modern Liberals also object to "fast track" provisions that prevent the U.S. Congress from challenging any details before the agreement is approved by the president.

6. *Foreign aid.* Modern Liberals are strong advocates of foreign aid to LDCs, but they acknowledge shortcomings in past efforts. When the aid is channeled through local governments, much of it ends up in the hands of ruling elites. When shipments of food are distributed from a central location, peasants must travel for days to obtain the aid, potentially resulting in neglect of their own crops. Aid in the form of advanced technology may eliminate jobs and cause unemployment. Although food during famines or health care equipment and manpower during epidemics are essential, Modern Liberals favor aid in the form of technical assistance and resources to initiate local projects that will lead to self-sustaining agriculture and industry. Another form of aid gaining popularity in recent years is "microloans" to potential entrepreneurs to promote new business activity.³¹

7. *The high road.* Free trade has the potential to foster a "race to the bottom" as nations compete with one another to attract investment by reducing business costs through deregulation, tax concessions, and weaker labor unions. Instead, Modern Liberals encourage nations to take the "high road" by competing on the basis of a highly skilled labor force, high-quality infrastructure, and well-funded research and development. Modern Liberals

argue that industrialized nations cannot win a “race to the bottom” because production costs will always be lower in LDCs. The “high road” requires government efforts to aid those industries and occupations bearing the brunt of the dislocations brought on by free trade. Modern Liberals argue that if society as a whole benefits from lower prices, increased efficiency, and innovation fostered by free trade, then society as a whole should share the burden of business failures and subsequent unemployment in industries suffering a loss of comparative advantage. Assistance might take the form of subsidies for job training or relocation, low-interest loans, or temporary trade restrictions to give industries more time to adjust to changing market conditions.

On balance, Modern Liberals remain optimistic about the potential for globalization to raise standards of living throughout the world. However, they caution that without efforts by both national governments and international agencies to actively promote social justice, preserve democracy and human rights, and protect the environment, globalization also has the potential to wreak havoc on national economies and nature.³²

NOTES

1. Classical Liberal arguments attributing lack of development to poor governance are presented in Daron Acemoglu and James Robinson, *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*. New York: Crown Business, 2012; Robert H. Bates, *Prosperity and Violence: The Political Economy of Development*, 2nd ed. New York: W. W. Norton, 2009; Hernando De Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*. New York: Basic Books, 2003; Anne O. Krueger, *Political Economy of Policy Reform in Developing Countries*. Cambridge, MA: MIT Press, 2003; and Deepak Lal, *Poverty and Progress: Realities and Myths about Global Poverty*. Washington, DC: Cato Institute, 2013.

2. The Classical Liberal critique of traditional development economics is presented in William Easterly, *The Tyranny of Experts: Economists, Dictators, and the Forgotten Rights of the Poor*. New York: Basic Books, 2011; Deepak Lal, *The Poverty of Development Economics*. Cambridge, MA: Harvard University Press, 1985; and Peter T. Bauer, *Reality and Rhetoric: Studies in the Economics of Development*. Cambridge, MA: Harvard University Press, 1984.

3. The Classical Liberal case against foreign aid is presented in R. Glenn Hubbard and William Duggan, *The Aid Trap: Hard Truths About Ending Poverty*. New York: Columbia University Press, 2009; William Easterly, *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*. New York: Penguin Press, 2006; Roger C. Riddell, *Does Foreign Aid Really Work?* New York: Oxford University Press, 2008; and Dambisa Moyo, *Dead Aid: Why*

Aid Is Not Working and How There Is A Better Way for Africa. New York: Farrar, Straus and Giroux, 2010.

4. Classical Liberal arguments for free trade and against protection are presented in Jagdish Bhagwati, *In Defense of Globalization*. New York: Oxford University Press, 2004; Edward L. Hudgins, ed., *Freedom to Trade: Refuting the New Protectionism*. Washington, DC: Cato Institute, 1997; Anne O. Krueger, *The Political Economy of Protection*. Chicago: University of Chicago Press, 1996; Melvyn B. Krauss, *How Nations Grow Rich: The Case for Free Trade*. New York: Oxford University Press, 1997; and Douglas A. Irwin, *Free Trade Under Fire*, 3rd ed. Princeton, NJ: Princeton University Press, 2009.

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Chapter 16

Science, Ideology, and Political Economy

Economics has never been a science—and it is even less now than a few years ago.

Paul Samuelson

Every human being has ideological, moral and political views. To pretend to have none and to be purely objective must necessarily be either self-deception or a device to deceive others.

Joan Robinson

The way we see things can hardly be distinguished from the way we wish to see them.

Joseph Schumpeter

In the decades following World War II, it became intellectually fashionable to proclaim “the end of ideology.”¹ Ideology was blamed for raising visions of heaven on earth, fueling fanaticism, and ultimately contributing to the rise of totalitarian systems on both the political left and right. At the time, fascism had been defeated and communism was presumed to be geographically contained until it would exhaust itself in a morass of economic inefficiency and political brutality. The divisive issues facing modern societies had seemingly been resolved in favor of democratic capitalism, and politics would subsequently consist of the administration of public functions by elected officials and appointed bureaucrats.

This vision proved to be premature. Although international relations among developed nations have been relatively peaceful and communism has indeed collapsed as predicted, ideological debates over economics, politics, and culture continue unabated. Most people profess to dislike ideology, viewing it as an intellectual strait jacket obscuring clear thinking. However, no person can escape ideology because humans are interpretive creatures struggling to make sense of what philosopher William James (1842–1910) called the “buzzing, blooming confusion” of the external world. Ideology is simply a name for the mental constructs used by humans to guide their thinking and behavior. In premodern times, religion served this purpose, but with the advent of science and democracy, ideas about the world had to be legitimized in secular and rational terms to gain serious consideration by scholars, policy makers, and the public.

The distaste for ideology can be traced back to the scientific revolutions of the 16th through 18th centuries. The medieval era provided humans with certainty that reality was a well-ordered system operating in accordance with natural laws of divine origin. The only prerequisite for correctly interpreting the external world was religious faith and openness to revelation. However, the cumulative impact of the Renaissance, the Protestant Reformation, and the scientific revolution shattered medieval knowledge. Out of the ruins emerged a growing confidence that human reason was sufficiently acute to interpret the world without the aid of established religious authority. The French philosopher Rene Descartes (1596–1650) and the English physicist Isaac Newton (1642–1727) affirmed the existence of God and an orderly universe operating in accordance with natural laws, but in their quest to combat dogma and superstition, they sought to develop a method for uncovering truth that was verifiable and, therefore, persuasive to all persons.

Descartes was haunted by the suspicion that his ideas were the work of a demon intent on deceiving him. Trust in sensory perception had been shaken by Copernicus’s discovery that a world appearing to be flat and motionless was actually round and spinning. Mistrusting his senses, Descartes advocated doubt and skepticism as essential to scientific inquiry. In an effort to penetrate to a deeper level of reality than the senses could reach, he expressed physical dimensions such as mass and speed with mathematics and then applied logic to discover the laws of nature. Since

only quantifiable aspects of the world could be captured by mathematics, Descartes's method created a distinction between an abstract, theoretical conception of reality and the actual world of objects and persons. Nonquantifiable aspects of reality were considered superficial and irrelevant for scientific knowledge. Thus, the Cartesian method, called "rationalism," relies on reason and logic to discover truth.

Although Newton shared many of Descartes's assumptions and methods, he insisted that verification of theories must ultimately entail testing against observed reality. The Newtonian method, known as "empiricism," recognizes that mathematics and reason may lead to a logical theory, but that theory may not correspond with reality. Newton accepted the role of reason in forming ideas, hypotheses, and theories, but demanded that these mental constructs be tested against facts to verify their status as scientific knowledge.

Scientists rely on both rational and empirical methods. The former relies on deductive reasoning to derive specific conclusions from general laws or principles. In contrast, empiricism uses inductive reasoning to construct general rules based on accumulated observations of facts. Both mathematical proofs and controlled experimentation are components of the process of scientific verification, and ideally each can be used to confirm the results of the other. This scientific method creates confidence that humans can understand the external world and, working within the laws of nature, improve the conditions of life.

Early political economists were heavily influenced by achievements in the natural sciences. However, the complexity of human society made empiricism, inductive reasoning, and controlled experimentation problematic. The social world contains so many interacting variables that efforts to isolate cause and effect in a verifiable fashion are exceedingly difficult. As a result, political economists were attracted to rationalism. They formed an abstract conception of humans by focusing on the most consistent and easily measurable aspect of behavior—the pursuit of wealth. This image of man as *homo economicus* was the starting point of classical political economy. Yet, John Stuart Mill acknowledged the fiction of *homo economicus* when he wrote:

Political economy does not treat of the whole of man's nature as modified by the social state, nor the whole conduct of man in society. It is concerned with him solely as a being who desires to possess wealth, and who is capable of judging of the comparative efficiency of means for obtaining that end.²

Having made this concession, Mill defended the continued reliance on the concept of *homo economicus* "not (because) any political economist was ever so absurd as to suppose that mankind are really thus constituted; but because this is the mode in which science must necessarily proceed."³ This statement reveals that a commitment to the scientific method has shaped the scope and content of much of political economy by effectively precluding consideration of those dimensions of life unsuitable for quantification and measurement.

If ideology is defined as reliance on values to interpret reality, then despite its aspirations to scientific status, political economy has been ideological from the beginning. Early political economists were clearly engaged in efforts to promote the interests of an emerging business class in its struggle against government control and remnants of feudal authority. Most modern economists might agree that every political economist prior to 1870, or perhaps even 1930, was an ideologue. Yet, even modern economists cannot avoid ideology. Theorizing necessarily entails abstraction, and science offers no certain guidelines as to which aspects of reality are most relevant. Facts have significance in proportion to their usefulness in achieving human goals and those goals are based on values. Therefore, the decision to focus on particular aspects of reality for the purpose of constructing theories is a value judgment. Even in empirical research, values influence which aspects of reality will be observed and what will be considered a "fact." In the social sciences, researchers deal with issues about which all humans have value-laden preconceptions, and these commitments cannot be kept separate from scientific inquiry.

Nineteenth-century French and German social scientists claimed that British political economy was based on faulty assumptions and fallacious reasoning. In fact, the field of sociology was established, in large part, as a reaction to political economy by French and German theorists such as Emile Durkheim (1858–1917), Max Weber (1864–1920), and Ferdinand Tonnies (1855–1936). Many, if not most, U.S. economists in the 19th century favored the empiricist and historical method developed in Germany

over the rationalist and deductive reasoning of English economists. Even in England, prominent economists such as Philip Wicksteed (1844–1927), F. Y. Edgeworth (1845–1926), and John A. Hobson (1858–1940) argued that economics was too abstract and narrowly defined to provide practical guidance in formulating public policy. The most renowned English economist of the late 19th century, Alfred Marshall, was praised by A. C. Pigou for realizing that:

excessive reliance on (mathematics) might lead us astray in pursuit of intellectual toys, imaginary problems not conforming to the conditions of real life: and further, might distort our sense of proportion by causing us to neglect factors that could not easily be worked up in the mathematical machine.⁴

Despite these reservations, economics subsequently became even more abstract and mathematical. During the 1930s and 1940s, the spread of fascism and communism motivated neoclassical economists to renew their commitment to the scientific method. The atrocities occurring within totalitarian systems created widespread disillusionment with all collectivist schemes, so increasing numbers of economists rejected the use of economics as a tool for fashioning activist public policies aimed at improving society. Intent on keeping ideology out of scientific research and analysis, these economists were attracted to a philosophy called logical positivism developed in Vienna during the 1920s. Logical positivism makes a clear distinction between *is* and *ought*, between fact and value, and between description and prescription. Only positive statements dealing with the world as it is can potentially be disproved (falsified) by comparison with facts. In contrast, normative statements, or judgments concerning what ought to be, are based on individual values and can, therefore, be neither confirmed nor falsified. Neoclassical economists welcomed logical positivism as a philosophical defense against totalitarian ideologies because it treats normative claims about how society ought to be structured as “meaningless” and, therefore, unworthy of serious consideration by economists.

This opposition to values applied only to the realm of science. Individuals would still be free to express personal tastes or preferences in the market or in their social activity. Logical positivists were determined to keep values out of science so that science could not be used to legitimize

government policies conflicting with the private values of individuals. Led by Lionel Robbins (1898–1984) in England, neoclassical economists sought to purge economics of all remnants of normative thinking; the world would be analyzed as it is, not as it should be.⁵ By restricting their analysis to logic and facts, they intended to distinguish themselves from mere ideologues seeking to impose unsubstantiated opinions and arbitrary values on the general public. By the 1950s, neoclassical economists had incorporated Keynesianism into their theoretical framework and effectively captured control of the economics profession.

The legacy of this turning point in the evolution of economics is apparent today. Neoclassical economic theory has become an almost completely mathematical exercise in logic, insulated from many of the forces shaping actual economic processes. In 1991, a group of economists commissioned by the American Economic Association to assess the conditions of graduate economic education in the United States concluded that: “graduate programs may be turning out a generation with too many *idiot savants*, skilled in technique but innocent of real economic issues.”⁶ In modern economics, the influence of new ideas often depends more on their internal logic and the sophistication of their mathematical expression than on their relevance to resolving real-world problems. Even some of the most prominent mainstream economists have expressed frustration with the state of affairs in their profession. Nobel laureate Ronald Coase (1910–2013) declared that: “in my youth it was said that what was too silly to be said may be sung. In modern economics it may be put into mathematics.”⁷

ECONOMICS AS IDEOLOGY

Despite the concerted efforts of several generations of economists to create a pure science of economics, values remain implicit in economic theory. (Note: the terms “economics,” “economist,” and “economic theory” shall hereafter refer to the neoclassical variants of these terms.) Examples of these values include the following:

1. *Humans should be free to pursue their individual interests as long as they do not violate the rights of others.* In addition to being obviously normative, this statement contains two hidden values. First, the term “individual interests” is interpreted to mean desires for private goods, services, and experiences; it does not include desires for the type of institutional context or societal values within which private activity occurs. Second, economists interpret “rights” to mean only property rights and those civil rights such as free speech that bestow no entitlement to economic resources. However, if rights were defined more broadly to include rights to economic benefits such as health care, a job, or a clean environment, then the individual pursuit of self-interest would be insufficient to protect the rights of citizens.

2. *Humans are rational maximizers of utility.* Economists have struggled for two centuries to determine exactly what *homo economicus* is seeking. The original claim that humans seek to maximize wealth was contradicted by everyday observations that many people do not direct their lives toward this goal. Beginning in the mid-19th century, economists used the word “utility” to describe the goal of economic behavior, but even this concept was criticized for portraying humans as pleasure-seeking hedonists. In the 20th century, economists tried to free themselves from any association with hedonism by developing the concept of “revealed preference.” People’s choices reveal their wants; if they had wanted something else, they would have made different choices. By resorting to revealed preference, economists implicitly acknowledge the circular meaning of utility. If utility is whatever people seek, then the claim that people maximize utility is tautological; it cannot be contradicted by fact because utility is defined to cover all possible behaviors. The same criticism can be made of the term “rational.” For an economist, behavior is rational if it is directed toward the attainment of maximum utility. But because individuals are assumed to be the only judges of their own utility, an outside observer cannot label any behavior as irrational. Like utility maximization, the claim that humans are rational functions as a tautology within economic theory. Since tautologies are immune to falsification, they function as ideology.

3. *Individual preferences are independent of the social environment.* Economic theory treats preferences as originating within the biological and psychological drives of the individual. This view contrasts sharply with the perspective of most sociologists and psychologists who emphasize the role of social conditioning and acculturation in shaping individual preferences. Why do economists adamantly defend such an implausible argument? Again, the desire to emulate natural science dictates this assumption. If preferences were treated as dependent variables, economists could no longer analyze the economy as a closed system separate from the political and sociocultural systems, and much of the precision and logic of economics would be lost. For example, economist Tibor Scitovsky (1910–2002) demonstrated that if preferences are dependent on the social environment, individuals in situation A might prefer situation B, but if situation B were attained, the different environment might cause the same individuals to prefer situation A.⁸ When preferences become a dependent variable, economists can no longer claim that markets generate a unique and stable equilibrium.

4. *All preferences for private goods or services are equally valid but deserve fulfillment only to the extent that they are backed by money.* The equal validity of preferences assumes that individuals are the best judges of their own interests. While this claim appeals to our sense of human dignity by recognizing the capacity of individuals to direct their own lives, it is ideological because it cannot be tested or even potentially falsified using standard scientific methods. Any action can be interpreted as serving a person's best interests because no method exists for assessing private interests. Moreover, this assumption blinds economists to both the private and social processes through which preferences arise. Individuals often struggle with their own preferences, experiencing conflict between immediate desires and prior commitments to other persons or moral principles. In addition to their preferences, individuals have "metapreferences," guiding them in choosing which of their desires to express and which to suppress. These metapreferences reflect the type of person the individual aspires to become. Treating all preferences as equally valid is thus unscientific because it fails to grasp essential aspects of

preference formation. The claim that preferences deserve fulfillment only to the extent that they are backed by money is a corollary of economists' definition of rights as including only property rights and those civil rights making no demands on economic resources. This claim is unscientific because the definition of rights is a value judgment.

5. Complete and perfectly competitive markets yield an efficient allocation of resources. This statement, which constitutes the core proposition of neoclassical economic theory, is nonscientific because the definition of efficiency is itself value laden. Markets will typically be inefficient if efficiency is defined as maximizing human satisfaction, as maximizing the attainment of societal goals, as maximizing the development of human capacities, or even as maximizing the expansion of output over time. Markets are only efficient in meeting economists' definition of efficiency: a situation in which individuals have completed all mutually beneficial transactions so that no person can be made better off without making someone else worse off.

Although real-world market economies are never fully efficient, economists construct theoretical models of a market economy by making assumptions that guarantee efficiency. They assume that markets are complete and perfectly competitive, meaning that markets exist for all goods in both the present and the future and are characterized by many small buyers and sellers, a homogeneous product, full information, and perfectly mobile resources. To grasp the tautological nature of the claim that complete and perfectly competitive markets generate efficiency, consider the following reasoning:

Assumption 1: When markets are complete and perfectly competitive, individuals are able to engage in all mutually beneficial transactions.

Assumption 2: Efficiency is a situation in which all mutually beneficial transactions have occurred.

Conclusion: Complete and perfectly competitive markets are efficient.

Economists rely on a self-fulfilling definition of efficiency due to theoretical difficulties encountered in the late 19th century. At that time, efficiency was hazily linked with the maximization of social utility. The claim that markets maximize the overall level of well-being in society provided a powerful argument in support of markets. However, economists subsequently realized that the notion of maximizing social utility presupposes the summing up of individual utilities, which requires interpersonal comparisons of utility. Since utility cannot be measured in any absolute sense, they rejected social utility as an unscientific concept. A second objection to the idea of maximizing social utility followed from the application of the law of diminishing marginal utility to money. If wealthy people get less satisfaction from an additional dollar of income than do poor people, then maximization of social utility would seemingly require massive redistribution of income from rich to poor. Most economists were unwilling to accept that conclusion and, led by Vilfredo Pareto, they proceeded in the early 20th century to propose a more modest definition of efficiency as a situation in which no person can be made better off without making someone else worse off.

Economists defend their conception of efficiency as value free and scientific, yet virtually all policy recommendations made by economists are based on increased efficiency. An obvious question arises: how can a value-free definition of efficiency provide a basis for determining what policies ought to be enacted without violating logical positivism's separation of *is* and *ought*? The answer is twofold. First, efficiency is not a value-free concept; it presupposes the values previously discussed in this section. Second, economists commit an ideological sleight of hand when they use words like "optimal" and "rational" as synonyms for efficient. If citizens were told that a particular policy would create an "optimal allocation of resources," they would understandably interpret that phrase to mean the best possible allocation. However, an efficient economy is consistent with conditions that would offend most people. For example, those individuals who, because of age or infirmity, are incapable of supporting themselves or securing private charity would be left to die.

The assumption that complete markets and perfect competition generate efficiency leads to the presumption that society is better off if markets are more competitive. Yet, economists Richard Lipsey and Kelvin Lancaster

(1924–1999) demonstrated that when the conditions of perfect competition are violated in two or more parts of the economy, restoring competition to only one part may decrease efficiency. For example, if a labor union faces a monopolistic employer, then weakening the labor union to improve competition may reduce efficiency. This “theory of the second best” calls into question any policy recommendations aimed at improving efficiency by increasing competition.⁹

6. *Unanimous consent should be required for any political changes to the economic status quo.* This value is explicitly stated by only a minority of economists known as property rights theorists. However, the definition of efficiency makes unanimous consent an implicit value in economic analysis. Any policy that increases efficiency would presumably receive unanimous support because at least one person is made better off and nobody is made worse off. However, because virtually all policies have redistributive effects harmful to at least one person, the unanimity rule effectively bars government action. John Hicks (1904–1989) and Nicholas Kaldor (1908–1986) attempted to loosen the criterion for efficient public policies by proposing a “compensation principle.” If those who benefit from a public policy could hypothetically compensate the losers and still be better off, the policy would be considered efficient. This idea provides the theoretical basis for cost–benefit analysis used by economists to assess the effectiveness of decisions and policies. However, cost–benefit analysis entails the inevitable introduction of values as economists must make judgments about which costs and benefits to consider and how to measure them.

REJOINDERS FROM ECONOMISTS

If the foregoing critique of economics is valid, why do many economists continue to defend the assumptions and scientific status of their discipline so aggressively? Consider the following arguments made by prominent economists:

1. English economist John Neville Keynes (1852–1949) admitted that economics was based on unrealistic assumptions and also that economists were unable to accurately predict specific future events. However, he defended the ability of economists to forecast long-run tendencies because, over time, the random effects of unknown variables would offset each other. However, any theory can be defended with the claim that its predictions will eventually be confirmed in the future. The ultimate response to this defense of neoclassical economic theory came from Neville Keynes's son, Maynard: "in the long run we are all dead."

2. English economist Sir Dennis Robertson (1890–1963) defended the assumption that humans are self-interested by arguing that while love, empathy, and altruism exist, they are too scarce to serve as the basis for social organization. This judgment is most likely accurate, but Robertson concluded that markets are the ideal coordinating institution because they economize on love by relying solely on self-interest. Compassion, altruism, and empathy can be reserved for personal relationships outside the economy. The problem with this argument is that economizing on altruism to create a good society is a bit like refraining from exercise to maintain bodily strength. The social structures and opportunities available to humans shape their capacities for particular sentiments and behaviors. A society organized solely around the principle of self-interest will generate strongly self-interested citizens. This phenomenon occurs because individuals in markets acting as isolated agents are relatively powerless to counteract market forces with noneconomic values. For example, employers who feel a moral obligation to pay higher wages to their employees may find themselves driven out of business due to higher labor costs.

3. Some economists defend the exclusive focus on self-interested pursuit of material well-being by arguing that any fuller description of human behavior would bias economics toward particular lifestyles. Whereas self-interest is claimed to be a necessary and universal aspect of human existence, other behaviors vary from individual to individual and culture to culture. This argument fails to recognize that ignoring nonmaterial values and motivations implicitly condones and encourages acquisitive lifestyles. A more objective description of human behavior would include other

universal traits such as self-reflection, compassion, playfulness, creativity, and the search for meaning, purpose, and identity.

4. Economists may admit that the 19th-century image of *homo economicus* as a maximizer of pleasure or wealth was unrealistic, but modern economic theory focuses on the broader concept of utility maximization, and utility can be derived from any pursuit of human interests. Therefore, they claim, economic theory is relevant to all contexts in which individuals pursue their interests under conditions of scarcity. This argument constitutes the most widely used defense of economics, but taken to its logical conclusion, it leads to tautology. As previously noted, if the pursuit of utility is broadly defined to encompass all possible choices, then a person could never act in a nonutilitarian manner. Tautologies are useless for practical application, so when economists apply theory to analyze real-world situations, they invariably narrow the concept of utility to focus on material interests most amenable to quantification as measured by money.

Economists are confronted with a dilemma. A broader concept of utility is attractive because it provides a quick defense against critics of *homo economicus* and legitimizes neoclassical economic theory as a valid method of inquiry in all dimensions of human existence. However, the broader conception of utility is tautologous and, therefore, nonoperational in practice. In contrast, a narrower conception of utility linked primarily with material gain provides economists with an analytical method for advising corporations and governments in making efficient decisions. However, to explicitly acknowledge a limited scope for utility would make economics vulnerable to charges of irrelevance in nonmaterial realms of behavior. Since neither of these choices is appealing, economists simply live with the dilemma, paying lip service to a broadly defined utility while practicing with a narrower concept.

5. Milton Friedman acknowledges that many of the assumptions of economics are unrealistic but claims that predictive capability rather than realism of assumptions is the hallmark of good science.¹⁰ In other words, if economic theory generates predictions confirmed by observation, then the realism of its assumptions does not matter. Using Friedman's criteria, the

field of macroeconomics has been a dismal failure. Economists have been unable to forecast future economic conditions accurately as evidenced by the embarrassing failure to predict the Great Recession of 2008. In fact, different economists offer such widely divergent forecasts that one consulting firm now gathers and averages the various forecasts to arrive at a consensus. Many corporations have reduced or eliminated their economic research departments due to unreliable forecasts of changing market trends.

6. A final defense of the assumptions and implicit values underlying economics is based on appeals to the necessity of adhering to the scientific method. When the human mind attempts to grasp reality, the overwhelming complexity of the world dictates reliance on the methods of abstraction, simplification, logical analysis, and controlled experimentation. Simplifying assumptions may entail human judgments of the relative significance of different aspects of reality, but without them, knowledge would be at a standstill. Moreover, without science, there would be no ultimate authority for distinguishing between knowledge and mere opinion. To openly acknowledge the presence of values in economics would, in the words of Nobel laureate James Buchanan (1919–2013), remove “all scientific content from the discipline and (reduce) discussion to a babel of voices making noise.”¹¹

The persuasive power of the foregoing argument derives from the implicit assumption that the scientific method, as practiced in the natural sciences, is the only reliable avenue for expanding knowledge about human behavior and institutions. From this perspective, researchers and theorists must approach their studies with objectivity and skepticism, be willing to reject established truths in light of new evidence, and remain open to consideration of new hypotheses and data. However, the scientific method also creates its own form of dogmatism. New ideas are given a hearing only when they are presented in a form amenable to logical analysis and empirical verification. While these processes may be useful for developing knowledge, they do not exhaust the sources of human understanding. The objectivity and detachment so prized by natural scientists actually pose barriers to inquiries into the human condition. The natural scientific method was originally designed to yield knowledge of causes and effects among

natural phenomena so that humans could better manipulate the environment to meet their needs. When this same method is applied to human activities, people are viewed as objects responding to external forces, and knowledge is geared toward prediction and control. The social scientist adhering strictly to the method of natural science can offer little insight into the requisites of a good society.

The dogmatism generated by an unwavering commitment to the scientific method is exemplified by economist Robert Hall, who informed an interviewer that he immediately stops reading any article in which he encounters the words “social” or “society” because he knows it will be unscientific. Perhaps the most insightful explanation for this dogmatism comes from economist Charles Schultze:

When you dig deep down, economists are scared to death of being sociologists. The one great thing we have going for us is the premise that individuals act rationally in trying to satisfy their preferences.¹²

Like all scientists, economists pride themselves on being rational, analytical, and objective. They accept an intellectual obligation to act as guardians of the economy, attempting to protect the market from ideological enthusiasm and the machinations of politicians. Yet, no matter how well intentioned, economists rely on a distorted vision of human behavior and social structures and, therefore, their analysis inevitably constitutes only a partial perspective.

THE SCIENCE OF POLITICAL ECONOMY

If economics is ultimately based on values, then it cannot be defended as a purely scientific approach to understanding social, political, and economic institutions. In contrast to the value-free stance of economics, political economy recognizes the inevitable presence of values in all social inquiry and, therefore, acknowledges the legitimacy of diverse approaches to knowledge. Political economy does not reject science but rather defines it more broadly as a disciplined, communicable, and nondogmatic effort to

expand the knowledge base with which humans are able, both individually and collectively, to improve the conditions of their existence. Using this definition, many alternative approaches to understanding the economy can be recognized as scientific. Accepting ideological diversity creates a hospitable climate in which adherents of different viewpoints can exchange ideas. In the words of British economist Frank Hahn (1925–2013):

We do not possess much certain knowledge about the economic world and ... our best chance of gaining more is to try in all sorts of directions and by all sorts of means. This will not be furthered by strident commitments of faith.¹³

Traditionally, social scientists have divided society into separate realms over which they claim exclusive domain. Economists deal with the economy, that portion of society characterized by voluntary exchanges among rational, self-interested individuals. Political scientists examine the polity in which individuals and groups pursue common goals and resolve conflicting interests through laws enforceable by government. Sociologists focus on society, where the cultural practices and behavioral norms of communities function to harmonize individual behavior and social order. These distinctions among economy, polity, and society are important but also misleading without additional attention to their interdependence. The three realms are actually different facets of the entire social system. No scientific guidelines exist for dividing this network into neat compartments. The boundaries of economy, polity, and society are porous and shifting because they ultimately depend on values emanating from each realm. Commercial or market values formed in the economy, political values developed through the governing process, and cultural values within community life interact with one another to determine the proper extent of economic activity, political authority, and social conditioning.

Economy, polity, and society each contain a “governance structure” serving to aggregate individual choices, coordinate these choices in an orderly manner, and circumscribe future individual choices. A governance structure is both master and servant with the potential for both oppression and liberation. The economy’s governance structure is the market. Through the price mechanism, markets allocate resources in a pattern responsive to individual choices and property rights. Market outcomes limit future choices by placing budget constraints on individuals and firms. The

capabilities of markets include providing a broad range of individual freedom, facilitating personal development through choice and competition, and promoting higher standards of living. In contrast, markets have exhibited notable deficiencies including instability, inadequate public goods, lack of sustainability, politically unacceptable levels of inequality, and an expansionist tendency to marginalize the political and social realms, thereby undermining potential remedies for the market's deficiencies.

The polity's governance structure is the state or government. Individual values and preferences are transmitted to the state through the voting process, with additional reliance on opinion polls, focus groups, town meetings, and issue forums. These preferences are processed by bureaucrats and elected representatives who then formulate laws posing constraints on individual choice that are backed by the coercive authority of the state. The state's capacities include providing public goods, correcting externalities, protecting individual rights, and serving as a symbol and agent of national unity. Some notable deficiencies of democratic states include susceptibility to manipulation by powerful private interests, weak mechanisms for enforcing internal efficiency and accountability, and the potential for abusing its power.

The governance structure for society is dispersed throughout numerous communities. A community consists of people sharing sufficiently similar values, traditions, and culture to create a sense of belonging and group identity. Communities materialize gradually as individual actions coalesce into cultural practices that are affirmed and nurtured because they are perceived as valuable to the community. Communities enforce these practices through institutions including parenting and schooling of young members, cultural traditions and ceremonies, and expressions of approbation and disapproval. Communities are stabilizing institutions because they integrate individuals into larger social units and thereby reduce the potential for conflict among members. Communities also provide a context within which individuals develop a sense of personal identity.

However, communities also contain several potential weaknesses. Community identities are based on a distinction between members and nonmembers that can degenerate into discrimination, hostility, and even warfare. Communities may be narrowly parochial and stifling, leading to

suppression of creativity, innovation, and diversity. Communities may not be democratic since leaders typically emerge without formal selection procedures and exercise power without formal constraints. Finally, communities have little control over the larger environment in which they function and are, therefore, fragile and vulnerable to larger economic and political forces.

The interaction among market, state, and community may potentially be destructive, but the three governance structures can also be mutually supportive. This support appears in two forms—discipline and enabling. Discipline places restraints on self-aggrandizing behaviors such as greed, power seeking, and opportunistic strategies to benefit oneself at the expense of others. Enabling facilitates the realization of capacities contributing to individual and societal well-being. Some highlights of the positive interactions among governance structures are presented in [Tables 16.1](#) and [16.2](#).

Table 16.1
Interactions among Governance Structures: Disciplining Effects

	Disciplining Effects on Market	Disciplining Effects on State	Disciplining Effects on Community
Market		Providing alternatives to oppressive states, dispersing power, strengthening individual rights	Providing alternatives to oppressive communities, creating pressure for efficiency and innovation, strengthening individual rights
State	Enacting laws and regulations, collecting taxes and fees, conducting macroeconomic policy		Enacting laws and regulations, defining and protecting individual rights, establishing educational policy
Community	Shaping consumer preferences, transmitting morality, generating peer pressure to conform to social norms	Generating grassroots political activism, establishing ethical standards, shaping voter behavior	

The potential synergies of market, state, and community are fully realized only when each governance structure is sufficiently strong to exercise its disciplining and enabling capacities. This condition, in turn, requires that no governance structure gains such dominance that other

structures are rendered ineffective. Allowing the market to marginalize either the state or community is like building a table with only two legs. No matter how the legs are arranged, the table cannot serve its function. A healthy society requires three mutually supportive institutional bases because humans have three essential modes of behavior. Economically, they act as autonomous individuals choosing between different actions based on calculations of personal advantage. Politically, they act as citizens to secure the laws and institutional structures governing their collective existence. Socially, they derive meaning and purpose by fulfilling their roles within communities. If any one of these modes of behavior is denied expression by an inadequate institutional base, the entire social system loses vitality.

CONCLUSION

Each of the four ideological perspectives examined in this book may be faulted for neglecting one or more of the three governance structures. Classical Liberalism, in its quest to shatter the organic unity of medieval society, elevated the market at the expense of government and community. Classical Liberalism proposed that the market would make the pursuit of material self-interest consistent with the well-being of society. The role of government would be reduced to that of a referee protecting property rights and enforcing contracts. What Classical Liberals fail to perceive is that strong governments and vibrant communities are essential to maintain smoothly operating markets. Without regulations and ethical norms, self-interested behavior destroys markets. When government is weak, mafias and militias arise as citizens attempt to secure through collective action what they cannot obtain individually. When communities are weak, an amoral society breeds conflict, crime, and litigation, making business activities increasingly costly and difficult.

Table 16.2
Interactions among Governance Structures: Enabling Effects

Enabling Effects on Market	Enabling Effects on State	Enabling Effects on Community
Market	Creating the tax base,	Generating jobs and

		improving political stability, distributing income without visible authority	prosperity, creating mutual interdependence, motivating individual initiative
State	Establishing well-defined and protected property rights, enforcing contracts, maintaining law and order		Providing physical infrastructure, funding social benefits, shielding communities from market forces
Community	Creating human capital, reducing transaction costs, establishing trust and respect for individual rights	Generating civic virtue, shared identity, social solidarity, reduced conflict, and volunteer organizations	

Radicals and Conservatives emphasize the important role played by communities in creating social stability and prosperity, but they have traditionally viewed both the market and government as potential threats to communities. Since World War II, Conservatives have moved closer to Classical Liberalism by accepting markets and criticizing government. Radicals have also evolved, acknowledging the positive aspects of markets and anticipating that a postcapitalist government can effectively manage markets to improve social well-being. However, despite their trenchant critiques of government and the market, neither Conservatives nor Radicals have yet developed a coherent vision appealing to a wide spectrum of voters in modern industrial societies.

Modern Liberalism became the dominant ideology of the 20th century by proposing to balance government and market, relying on each governance structure to suppress the deficiencies of the other and anticipating the full benefits of the capacities of both structures. However, Modern Liberalism ignores community, and much of its current disarray is attributable to this oversight. In the absence of healthy communities, government and market cannot function synergistically to resolve each other's deficiencies. For example, government efforts to promote equality are undermined by fraud, abuse, and opportunism as alienated individuals seek relief from competitive market forces.

The political gridlock currently afflicting modern societies is largely explained by the widespread presumption that reforms must be directed toward either freer markets or stronger government. The deficiencies of each governance structure are sufficiently well known that democratic

societies are unable to move boldly in either direction. Any proposals to increase the dominance of markets raise fears of instability, unemployment, externalities, monopolization, lack of public goods, concentration of wealth, erosion of democratic rights, and loss of national sovereignty. Efforts to strengthen government are met with concerns about waste, inefficiency, abuse of power, manipulation by special interests, and undermining of personal freedom. This stalemate has a positive effect since a victory for either side would be self-defeating. Excessive reliance on markets weakens trust, loyalty, and honesty so that government cannot rely on individual virtue to maintain social order and must necessarily become coercive.¹⁴ Conversely, the collapse of communist societies provides strong evidence that overly dominant governments are eventually toppled by market forces.

A plausible resolution to this dilemma does exist. If liberalism were to explicitly incorporate community into its theorizing and policy proposals, many of the seemingly irresolvable issues confronting modern societies might become manageable. However, since its inception in the political struggles against papal, royal, and aristocratic power, liberalism has been committed to individualism, viewing community as the source of parochial prejudices interfering with markets and government. Community is associated with emotional attachments, narrow-mindedness, and intolerance. Because liberalism, with its open disdain for community, has been the dominant ideology for the past two centuries, the unraveling of community life should come as no surprise. The fact that communities have managed to sustain themselves at all provides testimony to the deep human need for fellowship and shared purpose.

In 1982, Harvard political theorist Michael Sandel proposed the integration of a communitarian perspective into liberalism, creating a new ideological perspective called “communitarian liberalism” or simply “communitarianism.”¹⁵ This approach seeks to balance the individualistic focus on rights, autonomy, and choice against the communitarian emphasis on duties, participation, and commitment. Liberals react strongly against any proposals that might limit individual freedom, but communitarians are confident that commitments to and participation in communities will enlarge freedom by creating greater civility, trust, and a sense of purpose to guide individuals as they function in the market and practice politics.

Markets and governments, according to communitarians, actually erode freedom by imposing external economic and political pressures. Individuals are free only in the sense that their property rights and civil rights are protected and they may choose which transactions to make. But without a sense of purpose to give meaning to their desires, this freedom leaves individuals unsatisfied, seeking ever-elusive fulfillment through novelty and possessions. Isolated, alienated individuals manifest their frustration in low productivity, violence, opportunism, and self-destructive behavior. Classical Liberalism is blind to this phenomenon because it views all behavior as resulting from the choices of rational individuals.

Communitarian liberalism suggests that government must take the initiative in reinvigorating communities. Communities are relatively powerless to defend themselves against the encroachments of markets and governments and, therefore, cannot be the primary source of their own renewal. However, placing responsibility for rebuilding communities with government does not imply the need for bigger or more intrusive government. Instead of acting primarily as an external authority regulating the actions of individuals and businesses with threats of coercion, government can become the partner of communities in creating “free spaces” protected from both market and government within which participatory institutions foster communication, interaction, and a renewal of civic virtue.¹⁶

The most appropriate balance between markets, governments, and communities is not a fixed ideal. The desired balance may differ from nation to nation depending on resource endowments, cultures, and existing institutional arrangements. The balance may also evolve over time in response to changes in technology, deterioration of the environment, and overpopulation. Another fundamental challenge is posed by the increasing globalization of markets. Unregulated international markets will steadily erode the sovereignty of governments and of the communities within their jurisdictions. The political struggles of the past two centuries to regulate national markets and to make their functioning consistent with the public interest are being refought in the international arena. The alternatives are not free international markets versus regulated international markets. If international governing bodies do not coordinate economic policies, nations

will take separate measures to protect themselves because unregulated global markets are incompatible with national efforts to achieve a desired balance among market, government, and community. Contributing to the formation of institutions for international governance will be a major priority for political economists in the 21st century.

NOTES

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3. *Ibid*, p. 139.

4. A. C. Pigou, ed., *Memorials of Alfred Marshall* (1925). New York: Augustus M. Kelley, 1966.

5. See Lionel Robbins, *An Essay on the Nature and Significance of Economic Science* (1932). New York: New York University Press, 1984.

6. Anne O. Krueger, *et al.*, "Report of the Commission on Graduate Education in Economics," *Journal of Economic Literature* 29(1991): 1044–1045. For additional assessment of U.S. graduate education in economics, see Arjo Klamer and David Colander, *The Making of An Economist*. Boulder, CO: Westview Publishing, 1990.

7. Ronald H. Coase, *The Firm, the Market, and the Law*. Chicago: University of Chicago Press, 1988, p. 185.

8. Tibor Scitovsky, "A Note on Welfare Propositions in Economics," *Review of Economic Studies* 9(1941): 77–88.

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16. See Sara M. Evans and Harry C. Boyte, *Free Spaces: The Sources of Democratic Change in America*. Chicago: University of Chicago Press, 1992; and Robert Putnam, *Making Democracy Work: Civic Traditions in Modern Italy*. Princeton, NJ: Princeton University Press, 1993.

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