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**POLITICAL ECONOMY 301**  
Fall 2007  
**ECONOMIC LIBERALISM AND ITS CRITICS**

This course explores the relationship between politics and economics by surveying influential works of political economy. Its first part examines major systems of thought in relation to the historical development of capitalism in Britain and the United States: the classical liberalism of Adam Smith, revolutionary socialism, and the reformist ideas of John Stuart Mill, Henry George, and John Maynard Keynes. The second part considers more recent writings, with more of a focus on the USA. The historical nature of the course permits you to appreciate the ongoing dialogue between classical and contemporary views of political economy.

The Political Economy major at Williams aims to prepare students for active engagement in public life. This course has two purposes in relation to the major: first, to expose you to the intellectual roots of the political-economic theories you will encounter in your senior courses; and second, to provide a space for you to reflect about the ethical issues that arise whenever one seeks not only to analyze public policy, but to make it.

**Requirements.** This course requires the discussion and thoughtful analysis of many outstanding works of political economy--asking you to understand them on their own terms, to relate them to one another, and to consider their current relevance. The large number of written assignments reflects this priority: at least eight short (2-page) papers commenting on the readings assigned for the day the paper is due. Papers are due at the start of class. The class will divide into two groups, with one group turning in its papers on Mondays and the other on Thursdays. Everyone will have twelve opportunities to submit a paper, of which only the best eight will count. There will also be a regular final examination that requires the identification of key concepts as well as the writing of integrative essays. Observe the Honor Code guidelines for independent work (pp. 136-37 in the *Student Handbook*) in completing all the written assignments. For course readings, short internal citations (Smith *WN*, 567) are fine.

The eight short papers together count for 50 percent of your grade; the final exam counts for 30 percent; your class attendance and participation count for the remaining 20 percent. On the last, the quality and succinctness of your interventions are most important. Think before you speak and avoid repeating yourself. The course works best with discussions that are informed, vigorous, civil, and widely shared.

**Using this syllabus.** The syllabus has been annotated with some information about the authors and the themes of their work, mainly in order to leave more class time for discussion of ideas. It also includes study questions. These are meant to alert you to some of the most important issues raised by the readings. The study questions will also help orient our discussions in class, so be ready to address them.

**Papers.** What makes a good short paper on material like this? The best ones have several things in common. They explicate what an author is saying in a certain passage, consider its practical implications, and make some kind of critical commentary (about assumptions, or logic, or practical implications). In doing so, they show an understanding of the author's position that is informed by the whole reading assignment and not just a few pages. Many papers use study questions for topics; all should say clearly up front what their focus is.

**Readings.** The following required books can be found at Water Street Books:

Milton Friedman, *Capitalism and Freedom*;  
Friedrich Hayek, *The Road to Serfdom*;  
Albert Hirschman, *Exit, Voice and Loyalty*;  
Arthur Okun, *Equality and Efficiency: The Big Tradeoff*;  
Adam Smith, *The Wealth of Nations* (Glasgow edition, Liberty Press);  
Robert Tucker, ed., *The Marx-Engels Reader*.

The other readings are in a packet. Its first part is available immediately, at Seeley House; Part Two will be delivered there in the third full week, after the enrollment is settled.

**Schedule** (\* denotes a reading from the packet):

**Thu 9/6** Introduction and Organization

John Locke, *Second Treatise on Government*, Chapter 5 "Of Property," secs. 25-28 [photocopy to be handed out in class].

Locke's Chapter V has been considered an awkward defense of property and definitely not Locke at his best. These reflections nevertheless represent what has been an influential way of thinking about an important problem, justifying private property.

**I. CLASSICAL THEORIES OF POLITICAL ECONOMY**

**A. Free-Market Liberalism: Adam Smith**

**Mon 9/10** Principles of a Free Market Economy

*The Wealth of Nations* (henceforth *WN*), Introduction through [Book.chap.sec.] I.iii.,8; I.iv.1-5, 11-18; I.v.1-10; vi-vii (pp.--text not general introduction--10-36; 37-39; 44-46; 47-52; 65-81).

Adam Smith saw a direct link between the division of labor and human civilization. He considered this idea so important that he placed it first: the famous example of the pin factory is no digression but rather an illustration of what Smith considered fundamental to all that followed. The discussion goes on to relate the division of labor to market size and to money. Smith then turns to price determination in chaps. v.- vii. (which we will discuss also next time). There he employs what was in his time a fairly common scheme describing three great classes in society--those who earn their living from wages, those who live by profits, and those who receive rent. These definitions, based entirely on roles in production rather than on income levels (not to mention "lifestyles"), appear later in Ricardo and Marx. Smith assumed his readers were familiar with the typical economic structure of the English countryside, where laborers earning day-wages worked for farmers, who ran the enterprise in pursuit of profit and paid rent to landlords (who then of course spent most of it). Note: "corn" follows British usage to mean "grain;" "police" corresponds roughly to our "policy." "Stock" is just invested capital.

Study Questions:

1. Why is it, according to Smith, that some nations are rich while others are poor (i.)?
2. Do people really have a natural "propensity to truck, barter, and exchange one thing for another" (25)? How would Smith's argument differ if he had begun from Hobbesian premises—say, with a "propensity to steal"?
3. Compare the division of labor in Chapter I (the pin factory) with the examples given in Chapter ii. If the division of labor arises from voluntary decisions, why does it intensify work?
4. For Smith, how should we properly regard profit? How does he distinguish it from rent—economically and (it seems) ethically (vi.)?
5. What is the difference between "absolute demand" and "effectual demand" (73)? How do Smith's definitions compare with those of modern economics? Why is the distinction important?

**Thu 9/13** Prices, the Distribution of Income, and Economic Growth

*WN* I.viii.1-33, 36-48; I.ix.1-4, 11-24; I.x.a., I.x.b.1-34; I.x.c.1-32, 60-63; I.xi.a.1-9; I.xi.p.1-10; II.iii.1-9, 13-22, 28-32; (pp. 82-93, 96-102; 105-06; 109-15; 116-28; 135-46;157-59; 160-62; 264-67; 330-34, 337-39, 341-44).

The readings for this class focus on Adam Smith's views of the determinants of prices, income distribution, and economic growth. Here you can find his some of his most trenchant critiques of the guild system along with a view of markets that places labor (and the laborer) front and center. You'll also find a great deal of attention to

politics. Note: in Chapters x.a.2 and x.c, the "policy of Europe" refers to the mercantile system (which involved national economic strategy and had an important role for guild regulations) and "corporations" to guilds.

#### Study Questions:

1. What is Smith's rather complicated view of the relationship between high wages and general prosperity (pp. 91-93, 96-99)? Does it still apply in the international market of today? What do you think about Smith's (related) arguments about population and slavery (pp. 98-99)?
2. On pp. 79 and 116, Smith refers to a situation of "perfect liberty." What does he mean by this term? Do you think he would favor labor unions?
3. In chapter x., Smith discusses the perceived sources of inequality among wage laborers. What are the real sources of these differences, according to Smith? Do they suffice to explain wage differences today—say, between an NBA star and a housepainter? (Or between a housepainter and a housewife?)
4. In your opinion, is Smith right about his assessment (pp. 264-67) of the degree of confluence between the particular interests of each of the three fundamental social groups (those who receive rent, profits, or wages, respectively) and the general interest?
5. How does Smith distinguish between productive and unproductive labor (Book II, chap. iii)? (We will see a similar distinction at work in the tale of the profligate landlords at III. iv.) Is his argument here consistent with the discussion of the general interest on 264-67?

#### **Mon 9/17** Progress and Policy

*WN* III.iv.1-7, 10-18; IV.ii.1-15, 23-45; IV.ix.48-52; V.i.b.1-20, 25; V.i.c.1-2; V.i.d.1-8; V.i.f.1-16, 47-61; V.ii.b.1-6 (pp. 411-15; 418-22; 452-59, 463-72; 686-88; 708-20, 722-31; 758-64; 781-89; 825-27).

Here is Smith on how good government can result from the spread of markets—and how, in turn, government can foster market expansion and national wealth. In both cases he uses an argument that forms the bedrock of liberal optimism—that freedom has non-obvious, usually unintended, but highly beneficial consequences. Book III gives a quick historical sketch of how state power was tamed by capitalism—an account that, in broad terms, was anticipated by Montesquieu and the physiocrats, and has been repeated by many others since Smith's time. Books IV and V give us some of Smith's best arguments for *laissez-faire*--and for government. The former begins with the "invisible hand" passage, which occurs at the conclusion his argument about how to maximize aggregate national value-added (pp. 455-57). Because of its importance, both to Smith's purpose (here is a formula that directly involves the wealth of nations) and to liberal optimism generally, the argument deserves close attention. Book V (introduced and summarized at the end of chapter ix, Book IV) is on fiscal policy, but it contains lots of philosophical and sociological asides. Its careful discussion of appropriate revenue sources—especially the four maxims on taxes (825-28)--is still relevant today. Also revealing is Smith's honest statement of his misgivings (V.i.f.) about the same division of labor he praised so highly at the outset.

#### Study Questions:

1. Consider Smith's tale of the merchants, landlords, and "civil government" in Book III. Is the argument plausible? How do the relations between lords and farmers (those who lease land from the lords) change? How about the relations between lords and merchants?
2. Everyone's heard of the "invisible hand" but few realize, even when reading it, that it illustrates the conclusion of a classical syllogism or formal logical argument. Can you find this argument—three premises plus conclusion? Do you find it persuasive? That is (assuming it is logically valid), are the premises realistic?
3. What do you think of Smith's exception for national defense (ii. 24-30)? If the Acts of Navigation fall under it, what would not? (Would, say, a Chinese firm's purchase of a US disk drive company?)
4. In Smith's discussion of justice and revenue (715-20), how does justice emerge from the self-interested actions of sovereigns and litigants? Is Smith's account a convincing one—above all, does he answer a critic who alleges that auctioning judges' decisions to the party offering the greater bribe would be more "natural"?
5. Smith issues a scathing indictment of the division of labor for its effects on the minds of workers (pp. 781-86). Is his proposed remedy adequate? (Compare these passages also to his description of dissolute soldiers at IV.ii.42, pp. 469-71.) Does the increase in wealth from the division of labor make this sacrifice worthwhile in Smith's view, or in yours?

## Thu 9/20 Moral Foundations of Capitalist Society

Excerpts of *The Theory of the Moral Sentiments* from Heilbroner, *The Essential Adam Smith*, pp. 65-69, 78-110, 118-23.\*

Smith first published *The Theory of Moral Sentiments* in 1759, well before the *Wealth of Nations*, but he continued to think highly of it until his death. In it we may find support for some of the moral premises of the later, more famous arguments; but there are also points on which Smith may have changed his mind. (In the early nineteenth century German anti-liberal critics popularized the idea that he was seriously incoherent.)

### Study Questions:

1. What distinction does Smith make between beneficence and justice? What is the significance of each to the proper ordering of economic life?
2. What does Smith mean by “sympathy” and what role does it play in the *TMS*?
3. Do you think Smith (especially *TMS* 123) romanticizes the poor? How does the passage on p. 123 relate to his thinking as a whole?
4. What is the role of public life—through human vanity and the sentiment of shame—in sustaining morality? Does Smith muddle the distinction between shame and conscience?
5. Is this doggerel (from the Canadian writer Stephen Leacock) on target?

Adam, Adam, Adam Smith  
Listen what I charge you with!  
Didn't you say  
In class one day  
That selfishness was bound to pay?  
Of all of the doctrines that was the Pith,  
Wasn't it, wasn't it, wasn't it, Smith?

Can you reconcile the arguments in *The Theory of Moral Sentiments* with those in *The Wealth of Nations*? In particular, on the relationship between sympathy and the pursuit of self-interest?

## B. Elaboration and Critique of Economic Liberalism

### Mon 9/24 Ricardo and Marx

David Ricardo, *Principles of Political Economy and Taxation* (1821), chap. 5 and sec's. 11-19 of chap. 7.\*

Karl Marx and Friedrich Engels, “The Communist Manifesto” [1847], part I; excerpt from *Capital*, vol. 1, chap. 14, sec. 4; fragment from *The German Ideology*; opening passages from “Critique of Hegel’s *Philosophy of Right*”; and “On the Jewish Question,” part I. All are in Tucker, ed., *The Marx-Engels Reader*, pp. 473-83; 392-97; 160 (begin at “Further,...”)-163; 53-54; 26-46.

Smith's influence on political-economic thinking during the nineteenth century would be hard to overstate. But one notable difference can be seen already in Ricardo's more pessimistic tone. Much of this was due to the influence of Thomas Malthus and his famous population theory, according to which a geometric increase in population combined with an additive increase in food production entailed a future of increasing misery. It shows up here in Ricardo's argument about family size and the trend of real wages (its implications also animated Marx and Engels's rejection of “bourgeois ideology” in favor of a revolutionary alternative). Note: the poor laws in force until 1834, about which Ricardo writes, provided subsidy payments based on family size and were administered at the local parish level. The 1834 reform reflected the triumph of arguments like Ricardo's.

Marx and Engels critiqued capitalism in a much more fundamental way than have any of our previous authors, but you can see how they also depend on Smith and Ricardo. The “Manifesto” is the best expression of

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<sup>1</sup>From Stephen Leacock, *Hellements of Hickonomics* (1936), p. 75, quoted by Amartya Sen, *On Ethics and Economics*, p. 21.

their historical materialist argument that capitalism inevitably undermines its own foundations. In the other readings, of which the last are from the early Marx, we work backward to find out what he thinks it means to be free--genuinely emancipated. The first reading refers to different kinds of division of labor—one in which independent producers exchange goods in a market and another in which a factory manager assigns jobs to workers. While it's easy to expect Marx's antipathy toward the second, note his pejorative description of the first. The next reading is about how *any* settled division of labor restricts freedom and has as its political counterpart an "illusory form of communal life." The last two excerpts direct their critique toward religion and its role in a capitalist society. (Note: in "On the Jewish Question," be sure to distinguish between Marx's own words and his long quotes and paraphrases of Bruno Bauer.) Remember the key premise: Marx is an atheist. Seeing religion as a man-made fantasy, he sets out to explain where it comes from and why it is so strong even in a place (the northern US) with relatively free and democratic institutions and no established church. As this suggests, there is much more here than a critique of "the opiate of the masses."

Many others criticized Smith from a position of economic nationalism. Two of the most prominent arguments, from Alexander Hamilton (1791) and Friedrich List (1844), we will read later in the semester.

#### Study Questions:

1. What view of the economy lay behind Ricardo's recommendations about relief for the poor? Do you agree with his conclusions, and with his premises?
2. What historical role do Marx and Engels assign to capitalism? Do they, for instance, reproach it for having destroyed indigenous cultures around the world? Could a serious Marxist be an investment banker?
3. For Marx and Engels, "the executive of the modern State is but a committee for managing the common affairs of the whole bourgeoisie." How does this differ from Smith's view that "the proposal of any new law or regulation which comes from [the merchants and dealers]"..."comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public" (p. 267)?
4. Bourgeois intellectuals, according to Marx (p. 395), approve of rigorous planning and central control within factories, but are horrified at the prospect of extending such planning to the economy as a whole. Is there an important contradiction here?
5. Marx says that in his ideal society, "nobody has one exclusive sphere of activity but each can become accomplished in any branch he wishes," (and in the next, famous passage) "to hunt in the morning, fish in the afternoon, rear cattle in the evening...just as I have a mind" (160). Does this mean that the division of labor is abolished? Leaving aside his romantic examples of jobs, why does he think this is feasible? What do you think?
6. What, for Marx, accounts for the existence of religion, and for its greater strength in the country then distinguished by its lack of an established church?

### **C. Reformist Liberalism and Social Democracy**

#### **Thu 9/27** Private Property and the Role of Government

John Stuart Mill, *Principles of Political Economy*, pp. 199-234, 936-971.\*

In the nineteenth century, John Stuart Mill (1806-73) was just as famous for his political economy as for his other philosophical works. The *Principles* went through six editions in his lifetime (the readings come from the last of these, which came out in 1871). Through his father he was influenced heavily by Bentham's utilitarian thought, turning these principles in a reforming direction and staking out then-radical positions on free speech and women's rights. In these readings you see a lover of liberty with a relentlessly logical mind seeking to justify private property and government action, and perhaps straining logic when his valued principles come into conflict. Note that where Mill speaks of "communism" in the first pages of this selection, he is not referring to Leninist state socialism (which did not yet exist) but to factories, farms, and stores owned by workers or members of the community, like those of the Rochdale Pioneers.

### Study Questions:

1. Mill says that “the laws of private property have never yet conformed to the principles on which the justification of private property rests” (207). What does he mean by this, and how does he propose to remedy the problem?
2. Mill devotes a long section to the question of inheritance and bequest (218-26). Do you agree with his position? Why do you think the problem is so important to him?
3. Is it true that “the uncultivated cannot be competent judges of cultivation” (p. 947)? Who *is* competent to judge such matters? (Would it have sounded less elitist if he had said “education is wasted on those poor kids anyway”?)
4. How does Mill's discussion of defensible government interventions in the economy differ from that of Smith? How might you explain those differences?

### **Mon 10/1** Reformism in Britain after World War One: Tawney and Keynes

R.H. Tawney, *The Acquisitive Society* (1927), pp. 9-22, 36-43, and 55-69.\*

J.M. Keynes, “The End of Laissez-Faire” (1926), “National Self-Sufficiency” (1933) and, from *The General Theory of Employment, Interest, and Money* (1936), sections V and VI from chap. 12 on equity markets (pp. 153-61) and “Concluding Notes.”\*

World War One shattered the fundamental assumptions of the long nineteenth century (1815-1914), including the belief that rising economic interdependence, via trade and capital flows, would lead to international peace. Then, in 1917, the Russian Revolution (and smaller outbreaks in central Europe in 1918-19) presented a new menace to the established order. Finally, the war itself saw ambitious expansions of government power even among the most liberal combatants (the UK and US). Thus the old free-market orthodoxy was questioned from several directions at once. In response, like Mill but more pointedly, the generation of reformers after 1918 argued that some forms of private property unfortunately put the whole idea of private property into question. For Mill and Henry George (American proponent of the “single tax,” world famous in the late 19<sup>th</sup> century), the most important offender had been land. Tawney generalized the argument to what he called “functionless property.” This strain of thought might also be seen in the later Keynes on interest rates.

Born in India to an eminent family, Tawney (1880-1962) had the best education but also came into sympathetic contact with the people of London's East End. Like T. H. Green before him, he sought to ground rights in societal function. John Maynard Keynes (1883-1946) is famous for his *General Theory of Employment, Interest, and Money*, from which the last two excerpts come. Keynes thought the massive unemployment of workers during the Great Depression effectively refuted the classical liberal belief that capitalism would work well if only markets were left alone. A believer in personal liberty, he did not advocate the abolition of capitalism, proposing to rescue it through government intervention, yet his position on finance (including the “euthanasia of the *rentier*”) sounds radical today. Also, although Keynes was himself an immensely successful stock market investor (a rare case amongst economists!), he was skeptical of the ‘collective rationality’ of asset markets.

### Study Questions:

- 1) What is functionless property, for Tawney? Do you agree with his classification? How does the array of property rights in the contemporary USA measure up in terms of functionality?
- 2) Why does Tawney think that human beings cannot dispense with an idea of social purpose for property? What does social purpose have to do with job satisfaction?
- 3) Is Tawney a conservative or a radical? Why?
- 4) How does Keynes treat the relationship between free trade, global investment flows, and peace? Do you agree?
- 5) What does Keynes mean by “the euthanasia of the *rentier*” (Concluding Thoughts, p. 376)? How does it relate to his argument about finance (“let finance be national”) in “National Self-Sufficiency”? What do you think?

## II. CONTEMPORARY WRITINGS ON POLITICAL ECONOMY

### A. Contemporary Liberalism: the Defense of the Market

**Thu 10/4** The Case against Central Planning

F. A. Hayek, *The Road to Serfdom*, introduction by Friedman and pp. 37-111.

Perhaps the most important contribution of Hayek (1899-1992) to social theory is his insistence that knowledge--of talents, capacities, scarcities, and potential consumer demands--is dispersed among countless individuals, so central planners cannot coordinate all this knowledge as effectively as markets. Along with laying the groundwork for this important point, *The Road to Serfdom* develops an argument that central planning not only produces poverty, but also destroys liberty.

#### Study Questions:

1. Chapter VI of *The Road to Serfdom* posits a distinction between the formal operation of laws which apply to all people equally and the judgments associated with the operation of a planned economy. Why does he think there is a necessary opposition between planning and law? Do you agree?
2. For Hayek, just because a state formally codifies its decisions as laws, this does not necessarily mean that it practices "the rule of law." Why not? Why is this distinction important?
3. Hayek describes democracy as one means for attaining the end of liberty. Just saying something is democratic doesn't mean it is good, because the democratically imposed will of the majority can be just as dangerous to freedom as the rule of the autocrat (pp. 70-71): "Democratic control *may* prevent power from becoming arbitrary, but it does not do so by its mere existence." What do you think?
4. Hayek thinks planning is likely to kill democracy. Why? Do you agree? Does the experience of postwar Europe shed any light on this?
5. Hayek argues that the term "privilege" should not apply to the ownership of property: "to call private property as such, which all can acquire under the same rules, a privilege, because only some succeed in acquiring it, is depriving the word privilege of its meaning" (TRtS, 89). He contrasts formally open ownership with the closed ownership of feudal times. What do you think? If I am born rich, am I privileged or not?

**Mon 10/8** No class, Reading Period

**Thu 10/11** Hayek's Critique of the Welfare State

F.A. Hayek, *The Constitution of Liberty*, pp. 22-53; 306-323.\*

F. A. Hayek, "Competition as a Discovery Procedure."\*

Thanks in no small part to the force of Hayek's logic, few people still believe in the desirability of central planning. But if central planning is a dead issue, mustn't Hayek be irrelevant to the burning issues of our day? These excerpts from the *Constitution of Liberty* (1960) are part of Hayek's attempt to demonstrate the continued relevance of his arguments in the era of the welfare state. In "Competition as a Discovery Procedure," Hayek (1899-1992) returns to his theory of the market process, a theory which some have taken to be incompatible with and superior to the theory of the market in neoclassical economics.

#### Study Questions:

1. According to Hayek, "the more civilized we become, the more relatively ignorant must each individual be of the facts on which the working of his civilization depends" (CoL, 26). What does he mean? Assuming he is civilized, how does he know this? Does he give us, here or elsewhere, good reasons to submit to these unintelligible but critically important facts?
2. Early in his discussion of progressive taxation, Hayek says that the idea of the interpersonal comparability of utilities has been "generally abandoned" (309). Yet many policymakers and ordinary people continue to believe

that a rich person gains less utility than does a poor one from income gains of the same magnitude (not to mention that the idea is prominent in the Christian gospels). If we deny comparability, must we also abandon the Golden Rule?

3. According to Hayek, "What is required [in the field of taxation] ... is a rule which, while still leaving open the possibility of a majority's taxing itself to assist a minority, does not sanction a majority imposing upon a minority whatever burden it regards as right" (*CoL*, p. 314). Is this a good argument for a "flat tax"?
4. What do you think of Hayek's statement ("Competition..." p. 255) linking the value of competition to its production of unpredictable results? Does this exempt market outcomes from criticism?

### **Mon 10/15** Liberty, State, and Market

Milton Friedman, *Capitalism and Freedom*, Intro., Chaps. 1, 2, 7, 10.

Milton Friedman (1912- 2006) was Ronald Reagan's favorite economist. An early opponent of Keynesian economics (though not initially on public-finance grounds), he did important work on economic methodology, the consumption function, and most famously, on money. But he also wrote influential works of advocacy, like this one and the lighter *Free to Choose*, which have been important guides for Republicans in recent years.

#### Study Questions:

1. In his discussion of monopoly (28), Friedman says that exchanges are voluntary where both parties have alternative options that are nearly equivalent. Does he believe that market participants usually have such alternatives? If so, is this a reasonable belief? If such alternatives do not exist, are we somehow unfree?
2. Friedman says that markets offer a kind of proportional representation (15). Thinking of this passage and others, would you say he is a democrat?
3. Friedman argues that minorities have often wrongly blamed capitalism for the "residual restrictions" upon their lives, "rather than recognize that the free market has been the major factor enabling these restrictions to be as small as they are" (p. 109). What do you think?
4. Is Friedman a utilitarian in his argument for free markets, arguing that they maximize well-being, or does he stand on somewhat different ground?
5. Are inequalities resulting from chance easier to accept than those from other sources (pp. 165-66)? Who is the better liberal on this point, Friedman or Hayek (*TRtS*, 104), who seems to argue the opposite? How would things be different if economic rewards were distributed entirely randomly?

### **Thu 10/18** Liberal Principles Applied

Friedman, *Capitalism and Freedom*, Chaps. 6, 11-13.

Here Friedman takes on the problems of public schools, public housing, and anti-poverty policy. Along with his thoughts on the proper role of the central bank, perhaps the most enduring contribution of Friedman's book to public policy debate is its proposal of a voucher system for education. The idea was embraced by the Reagan administration under the influence of William Bennett, a Williams graduate.

#### Study Questions:

1. Friedman takes the individual to be the "ultimate entity in society" (p. 5). Based on what you've seen in this book, where does Friedman think the values, beliefs, and preferences of individuals come from? Are they shaped by our society? If individual wants are social creations, should we respect consumer sovereignty?
2. Friedman's proposal for a negative income tax stands in stark contrast to the conservative welfare reform enacted in the mid-1990's, which was more paternalistic and intrusive—and less generous. In your opinion, is the difference a result of Friedman's being too liberal (in the classical sense)—that is, loving liberty too much?
3. How would you evaluate Friedman's proposal for school vouchers?
4. Friedman hints (p. 197) that much of the case for liberalism may rest upon our ceasing to assume that public officials are beneficent and disinterested. This idea, in others' hands, helped ground a whole branch of political economy now called (somewhat misleadingly) "public choice." Is the assumption of self-interested official behavior a good one? Of the figures we've read so far, whose arguments does it challenge most decisively?

**Mon 10/22** Microeconomics and Renascent Liberalism: Ronald Coase

Ronald Coase, "The Nature of the Firm."\*

Ronald Coase, "The Problem of Social Cost."\* [skip sections III and IV]

The two articles we discuss today are largely responsible for Coase's 1991 Nobel Prize in economics. In "The Nature of the Firm" (1937), Coase (b. 1910) introduces the fertile concept of transactions costs, a concept whose implications are still being explored by economists. It has political-economic implications, too. In "The Problem of Social Cost" (1960), Coase suggested that free markets were in fact able to correct many of the problems associated with externalities that conventional theory generally believed could only be addressed by government action. After attending a dinner party at which Coase presented these ideas before their publication, Milton Friedman commented that he had witnessed a revolution in economic thought. By the end of the twentieth century this had become the most often-cited article in economics.

Study Questions:

1. The central puzzle of "The Nature of the Firm" occurred to Coase when he was an undergraduate (and a socialist), just after visiting Ford and GM: how could liberal economists fault the USSR for being run like a big factory when some very large firms can be run efficiently? Do you think he answers this question adequately?
2. Following Coase, what effect might we expect, on the economically optimal size of firms, from recent advances in information technology?
3. According to Coase's famous argument about social cost, in the absence of transaction costs, the socially efficient use of resources will be obtained if property rights are clearly defined--regardless of their distribution. Are there any reasons to doubt this? (Imagine that we had trade in human kidneys. Would it make any difference whether people were initially assigned property rights to the kidneys in their own bodies? Would each of us end up with the rights to "our" kidneys in any case?)
4. Given that in the real world, transaction costs are often significant, Coase maintains that the socially efficient use of a disputed resource would be obtained if the property rights to it were assigned to the party who would pay the most for them. How would the decision be made? What would Hayek think of this implication?

**B. Defenses of Politics, the State, and Democracy**

**Thu 10/25** An Economist Defends Politics

Albert O. Hirschman, *Exit, Voice, and Loyalty*, Chaps. 1-4, 7 (all but pp. 83-98), and 8 (to page 114 only).

Albert Hirschman was distinguished for his adept and enlightening "trespasses" across the boundary between politics and economics. His empirical works deal with power, trade, and economic development, but this book has been his most influential contribution to political economy. In what at first may seem a long statement of the obvious (or what is obvious to everyone except economists), he created a new vocabulary for looking at a wide range of problems. One of his underlying premises--that organizations are costly to create--is shared by what has lately become a whole new field called "the new institutional economics."

Study Questions:

1. Hirschman criticized the typical economist's bias for "exit" over "voice" and later (Chap. 8) remarks upon an American preference for "exit" as well. What drives the choice between one and the other? Would we have better politics and a stronger economy if we chose "voice" much more often than we do? Why or why not?
2. One novelty of Hirschman's book lies in its conception of "voice" (petitions to management, consumer complaints, ongoing communications between firms and their suppliers) as relevant to economic analysis. In your opinion, what is its most important implication for the liberal ideal of the self-regulating market?
3. Compare Hirschman and Friedman on the issue of schooling. Are Hirschman's arguments (especially in Chapter 4) enough to undermine Friedman's argument for free choice and vouchers? Why or why not?

4. Hirschman's book is sometimes criticized for not giving greater prominence (beyond his mention of it at 82-83) to the idea that the threat of exit is crucial to having one's "voice" taken seriously. What do you think? Are there situations in which such a threat has the opposite effect?
5. According to Hirschman (Chapter 7), why might irrational national chauvinism be an advantage for countries trying to advance economically in the modern world? How would a liberal object to this thesis?

### Mon 10/29 Equality and the Welfare State

Arthur Okun, *Equality and Efficiency*, Chaps. 1 and 2.

Arthur Okun (1928- 1980) did most of his empirical work on labor markets and price theory. However, as a former policymaker and a lucid writer, he was also capable of writing a book that describes as clearly as any the areas of conflict between market distribution and political rules.

#### Study Questions:

1. Why, for Okun, must a clear line be drawn between dollars and rights? Do you agree with his reasoning?
2. Do you think the line between dollars and rights is clear enough, or in the right place, in the contemporary U.S.? Thinking of examples, would clarifying or moving this line have the beneficial effects Okun expects?
3. Here is one implication from Okun's placement of the line between dollars and rights: it would be better not to have the current, relatively high degree of inequality in the provision of defense counsel to criminal defendants, where the rich get the best defense money can buy and the poor often get an underprepared public defender. What do you think?
4. Okun found "the tolerance of the masses for economic inequality ... puzzling" (p. 33). How would you explain that puzzle? Why don't the poorest 51 percent of the voters expropriate the richer 49 percent?
5. Okun claimed that "To evaluate the net gain in freedom provided by private ownership (rather than public access) for any asset requires a balancing of pluses and minuses. The plus is the enhanced scope of the owner through exclusive powers over the asset; the minus is the restriction the keep-off sign imposes on non-owners" (37). What do you think? Does one person's property restrict the freedom of everyone else?
6. According to Okun, "the issue of government versus private ownership of industry has little to do with freedom, but much to do with efficiency" (p. 61). Friedman and Hayek would obviously disagree. Who's right?

### Thu 11/1 Inequality of Result vs. Equality of Opportunity?

Paul Krugman, "The Great Wealth Transfer," *Rolling Stone* 30 Nov 2006.\*

Bruce Ackerman and Anne Alstott, *The Stakeholder Society* (1999), chaps. 1-2.\*

Jacob Schelsinger and Nicholas Kulish, "As Paper Millionaires Multiply, Estate Tax Takes a Public Beating," *WSJ*, 7/13/00.\*

"Defending the Estate Tax," *The New York Times* (editorial), 2/16/01.\*

In the mid-1990's, after almost two decades of rising income and wealth inequality, welfare benefits in the U.S. were made more restrictive. Krugman presents a comprehensive analysis of wealth distribution along with a polemic against the role of public policy in changing it. In the central reading of the day, the book by Ackerman and Alstott proposes a radical proposal for wealth redistribution--in the name of equal opportunity and freedom. The two opening chapters from this book are followed by some clips on the estate tax.

#### Study Questions:

1. If there is no [absolute] poverty, should we care about [relative] inequality?
2. Why—apart from the point about poverty noted just above--might a liberal such as Hayek or Friedman argue that the apparent trend of income and wealth distribution should elicit no policy response by the government? Do you agree?
3. Would Ackerman and Alstott's proposal really achieve a substantial increase in equality of opportunity? At too great a cost, in your opinion?
4. Would the repeal of estate taxes weaken the legitimacy we ascribe to wealth by gradually undermining the presumption that wealthy people got rich through their own talent and effort?

## Mon 11/5 Power and Autonomy at Work

Samuel Bowles and Herbert Gintis, *Democracy and Capitalism*, Chap. 3 (to p. 87 only).\*

John Case, "Collective Effort," *Inc.* January 1992.\*

"A Firm of Their Own," *Economist* 6/11/94.\*

Farhad Manjoo, "United's ESOP Fable," *Salon.com* 12/12/02.\*

Daniel Pink, *Free Agent Nation* (2001), chap. 1. (pp. 9-25) and pp. 178-181.\*

"Prison as Profit Center," *WSJ* 3/15/01.\*

Here we return to the workplace, where we began with Adam Smith and visited later with Marx, Mill, and Coase. Nearly all of these readings present various arguments, on efficiency and equity grounds, against the existing structure of corporations. The work of Bowles and Gintis, radical economists at the University of Massachusetts, Amherst, makes the case that economic power should be just as accountable as formally constituted political power, ending up by advocating that a firm's employees should own it. The next three readings discuss that option in practice. The excerpt that follows is from a widely praised book that heralds the rise of independent white-collar jobs as an opportunity for self-actualization and resolving the conflict between work and family life (there may seem to be a lot of pages here but they read very fast). The final article describes a different but increasingly important kind of workplace, and returns us to issues raised by Bowles and Gintis.

### Study Questions:

1. What is the "labor commodity" proposition? Do you agree with Bowles and Gintis' critique of it? Could you agree with their critique and still disagree with their conclusions?
2. How about the "asset neutrality" proposition? Do we have to assume that all good ideas get funded in order to regard capitalism as fair? Efficient?
3. Referring to the magazine articles, what are the advantages and problems of employee-owned firms? Are these understandable in the terms articulated by Bowles and Gintis?
4. How does Pink think the "free agent nation" changes the politics of work? Do you agree?
5. Thinking of Coase, does Pink give us good economic or technological reasons to believe that the firm is now passé? What limits might there be to the feasibility of free agency?
6. How does prison labor relate to the issues raised by Bowles and Gintis? Is the spread of prison labor a good idea? What does it imply, for example, for the US position in negotiations over human rights with China?

## Thu 11/8 Information and the Critique of Finance

Doug Henwood, *Wall Street: How It Works and For Whom* (1997), pp. 72-86.\*

James Surowiecki, *The Wisdom of Crowds* (2004), chaps. 1-4.\*

Ian Welsh, "Greed, the Bubble, and the Bond Rating Agencies," *The Agonist* blog 8/22/07.\*

Asset markets are where the idea of markets-as-aggregators-of-the-best-available-information is most celebrated and most contested. And interesting. On one side, our news organizations have institutionalized the Dow Jones Industrial Average as a ready barometer of the economic weather, to the point where pundits talk about "the market" as some kind of oracle. On the other side, we have the Wall Street of asymmetrical information, "buy on the rumor, sell on the news," big egos, and gargantuan paychecks.

There are a lot of pages here but they read very quickly. In the Henwood piece we read a contemporary version of the Keynes critique from *The General Theory*, directed at Wall Street. Editor of *Left Business Observer*, he earned this reaction from the then-Executive Editor of the *Wall Street Journal*: "you are scum"...it's tragic you exist." This approximates Henwood's own attitude toward the financial sector (not the people but the system). He argues that Wall Street serves no economic purpose worthy of its immense wealth and power. The last reading, by Surowiecki, builds on Keynes in a different way, by asking when the "average wisdom" of large groups of people does (*Who Wants to Be a Millionaire?*) or does not (asset price bubbles) improve upon individual human rationality. Welsh brings us back to the issue of the incentives facing fund managers and purveyors on information in recent experience on Wall Street.

### Study Questions:

1. What is Henwood's argument against the view that the stock market is an important source of investment capital? Do you agree?
2. So what, for Surowiecki, distinguishes situations in which the aggregate judgment of a crowd is wise from those in which it is biased and wrong?
3. What does his conclusion about the judgment of experts imply about highly paid fund managers and CEO's? Do you agree?
4. What do Henwood and Welsh see (or imply) as the appropriate role for the financial sector in our economy? Do you agree? Either way, on what basis do you, and they, make this judgment?

### **C. Community, Sustainability, and the Market**

#### **Mon 11/12** Is "More of the Same" Feasible? Social Scarcity and Positional Goods

Jonathan Kaufman, "Amid Economic Boom, the 'Haves' Envy the 'Have-Mores'," *WSJ* 8/3/98.\*

Fred Hirsch, *Social Limits to Growth* (1976), pp. 1-54.\*

Robert Frank and Philip Cook, *The Winner-Take-All Society* (1995), pp. 1-14.\*

Conventional economics focuses on the policies most conducive to rapid and sustainable economic growth, since it is commonly held that economic growth promotes human happiness and well-being. Writing in 1976, Fred Hirsch questioned the wisdom of these policies by asking if growth can actually deliver the benefits it promises. He focused on people's desire for relative rather than absolute gains, coining the term "positional goods." The Frank and Cook book can be seen as an update or an elaboration of Hirsch, with less philosophical depth but with a few added wrinkles and using more contemporary economic language. In these pages they describe "winner-take-all markets" and their effects. The first article vividly depicts paycheck envy during the dot-com boom; similar things have been written more recently about the attitudes of merely rich Wall Streeters toward hedge-fund managers.

### Study Questions:

1. What are positional goods, and why does Hirsch think they have important implications for our thinking about the political economy of affluent societies?
2. Hirsch believes that "education"... "is a filter as well as a factory" (p. 48). What does he mean by this? Why does he think it is wasteful? Would we all be better off if Williams College were reduced to an Office of Admissions that handed out certificates of virtue to five hundred people a year, leaving them to learn relevant skills immediately in actual jobs?
3. One possible response to the increased competition for leadership positions is for the compensation attached to them to fall. Hirsch provides a list of reasons for expecting this *not* to occur. Do you find his list persuasive?
4. Are there significant differences between Hayek and Hirsch on the question of how to deal with the problem of the "tyranny of small choices"? (See Hayek, *Constitution of Liberty* pp. 50-52).
5. What are "winner-take-all markets" and why do Frank and Cook think they are harmful? What kinds of market failures do they see? Do you agree?

#### **Thu 11/15** Does Modern Capitalism Undermine its Moral Foundations?

Hirsch, *Social Limits*, pp. 111-14, chaps. 8 (117-22), 10 (137-51), and pp. 169-77.\*

Robert Putnam, *Bowling Alone: The Collapse and Revival of American Community* (2000), chaps. 1, 8, second part of chap. 9 (pp. 166-80), and 19.\*

Putnam's widely praised book was the fruit of a major research project, and national conversation, that began with his 1995 article by the same title. It also brings home many of the themes of a previous work, *Making Democracy Work* (1993), a comparative study of the regions of Italy. Putnam argues that our "social capital" (roughly, the degree of sociability, engagement in public affairs, and interpersonal trust) makes a variety of important contributions to the good life, that it has been declining significantly in the United States since the late 1960's, that

the decline has several identifiable causes, and that we ought to do something about it. Hirsch concluded something similar in 1976, but he saw the norms of our market society as the problem, and found no easy solutions.

#### Study Questions:

1. For Hirsch, why do a society's moral resources inevitably get depleted? What consequences does he see for capitalism?
2. What is the difference between "bridging" social capital and "bonding" social capital? Using examples from the rest of the selection, what are the most important implications of each? Which is more needed today, according to Putnam? Do you agree?
3. What is generalized reciprocity and why is it important? Do you agree with Putnam's conclusion that it has eroded and that we ought to do something about it?
4. Why would Putnam's analysis lead you to think that markets—or the Internet—do not automatically fill social capital deficits?

#### **Mon 11/19** Economic Nationalism

Alexander Hamilton, "Report on Manufactures" (1791), excerpts.\*

Friedrich List, *The National System of Political Economy* (1844), excerpt.\*

Lester Thurow, *Head to Head* (1991), excerpts from Chaps. 2 and 4.\*

Patrick Buchanan, *The Great Betrayal* (1998), pp. 44-68.\*

Byron Dorgan, *Take This Job and Ship It* (2006), pp. 18-29.\*

Paul Krugman, "The Illusion of Conflict in International Trade," from *Pop Internationalism* (1996).\*

In the 1980's, the debate over national competitiveness gave us metaphors of countries as firms and as economic warriors. Part of the idea was to wake policymakers up to pressing national problems, presumably because many of these can only be solved today (if at all) at the national level. We have included Hamilton and List here to show some of the antecedents of economic nationalist thought (and we had no space to squeeze them in earlier). Hamilton responds directly to Smith's response to the infant-industry argument. To Hamilton's discussion of international politics, List adds an antipathy toward merchants often found in nationalist writings. Thurow (Williams '60) takes the argument into microeconomics, while the Buchanan and Dorgan excerpts bring us up to date and offer vivid examples. Krugman's 1995 article responds to key arguments of the trade critics.

#### Study Questions:

- 1) What is Hamilton's response to Smith on infant industries? Where does Krugman stand?
- 2) Is Smith's exception for defense (recall his discussion of the Acts of Navigation) large enough to warrant Hamilton's argument? What about List's?
- 3) For Thurow, what is the significance of the distinction between product and process technology? What does it have to do with comparative advantage (compare Smith, WN I. ix.22, pp. 77-78)?
- 4) "Man is a consumer, but he is also a tool-using animal. As a tool-using animal, work is not a disutility. It determines who one is. Belonging, esteem, power, building, winning, and conquering are all human goals just as important as maximizing consumption and leisure" (p. 118). Is this right? How might a liberal respond?
- 5) Much of what Buchanan and Dorgan argue can be seen as an appeal to patriotism and national community sentiments--in particular, that we ought to value these attachments over narrow economic interest (Wal-mart's low prices) or international attachments. Where is Krugman on this? And you?
- 6) Economic nationalists also appeal to what in international relations is known as Realism or *realpolitik*—namely, that states rationally pursue power because the world is anarchic and, as a consequence (to quote the Athenians recorded by Thucydides) "the strong do as they will and the weak do as they must." So which is more "realistic," in your opinion: IR realism, which supports viewpoints like those of List or Buchanan, or the individualism of Adam Smith and Milton Friedman, in which *people* pursue their economic self-interest and we should regard this as a good thing?

**Thu 11/22** No class, Thanksgiving

**Mon 11/26** Immigration, Community, and Globalization

Robert E. Goodin, "If People Were Money..." and  
Brian Barry, "The Quest for Consistency: A Sceptical View," from Barry and Goodin, eds., *Free Movement*  
(1992).\*

Jason DeParle, "Fearful of Restive Foreign Labor, Dubai Eyes Reforms," *NY Times* 6 Aug 2007.\*

Here we take on the subject of immigration in philosophical terms. Goodin's premise is that a consistent liberal would not treat people and money differently, but that many self-described liberal democracies do so anyway. Barry thinks consistency is not the most important value, and tries to anchor policies restricting immigration in various economic ideas as well as bringing up the problem of social welfare. The article on Dubai considers recent events in a country that has become the exemplar of a particular kind of globalization, based on free trade and capital movements combined with an overwhelmingly imported (temporary resident noncitizen) workforce.

Study Questions:

- 1) Goodin argues that it is wrong to treat people and money differently when it comes to laws regulating their crossing of international borders. Why does he think we should be consistent on this point? Can you believe in personal freedom and not believe in free immigration?
- 2) Barry argues that the welfare state would not be able to exist without restrictions on immigration. Does this pose a problem for the left? How might that problem be solved?
- 3) Are the workers in Dubai free enough, given that they freely migrated there?
- 4) Does Dubai present a cautionary tale for advocates of guest worker programs? Why or why not? What would politics in the USA look like with a resident noncitizen population of similar size?

**Thu 11/29** Market and Place, 1: Suburban Sprawl

Andres Duany, Elizabeth Plater-Zyberk, and Jeff Speck, *Suburban Nation: The Rise of Sprawl and the Decline of the American Dream* (2000), chaps. 1, 2, 7, and conclusion.\*

This book represents a good summary of what is now called the "New Urbanism" in architecture and city planning. It contends that suburban sprawl damages our quality of life not only by bringing the obvious problems of lost open space, abandoned city poor, and congested freeways, but also more deeply, in ways relating to community and aesthetics. It ties in with themes articulated by Hirsch and analyzed, from a different angle, in the Putnam book.

Study Questions:

1. What, according to the authors, have been the main public policies responsible for suburban sprawl? Do you agree, or might there be other factors?
2. Why do they think sprawl makes us unhappy? Do you agree? Would you prefer to live in one of their projects, or in a gated subdivision of conventional design?
3. Thinking about their recommendations, do the authors effectively answer Philip Howard's charge (*Death of Common Sense*, 1996) that they wish to impose another form of detailed regularity on builders? If not, can anything be said in their defense?
4. Are the authors really "traditionalists," as they claim, or merely big-government, interventionist radicals? In particular, what might Hayek think about their position?

**Mon 12/3** Market and Place, 2: the Economy and the Environment

Herman Daly, *Steady State Economics* (1978), pp. 180-94.\*

Daly, "Postscript," chap. 20 in *Valuing the Earth* (1993).\*

Mark Sagoff, "Do We Consume Too Much?," *Atlantic Monthly* June 1997.\*

Paul Ehrlich, et al., "No Middle Way on the Environment," *Atlantic Monthly* Dec. 1997.\*

Draft of reply by Sagoff

Richard Posner, *Catastrophe* (2004), pp. 150-65.\*

One of the most pressing issues facing political economists is the appropriate relationship between humanity and the environment. While Hirsch asked us to look at the social limits to growth, limits that have implications about how we should deal with environmental problems, Herman Daly--for many years an economist at the World Bank--asks us to attend to the biophysical limits to growth. Mark Sagoff, who teaches philosophy and public affairs at the University of Maryland, disagrees with Daly and others, arguing that technology and markets can and will overcome scarcities, but that the reasons for being an environmentalist lie elsewhere, on a spiritual plane. Ehrlich and his co-authors disagree, in an article written in response to Sagoff's. The final reading considers how economic analysis can clarify our policy approach to global warming. Its author, Richard Posner, is well known and influential as a jurist (Seventh US Court of Appeals) and legal scholar (U. Chicago) whose political sympathies lie on the libertarian right. Yet he takes climate change very seriously. He employs tools of the "economic analysis of law" (which he helped found) to the problem of assessing and preventing damage from global warming.

#### Study Questions:

1. Daly claims that there is an "optimal scale" to a market economy? Why does he think that prices don't tell us what that scale is? Do you agree?
2. If Daly is right to believe there are biophysical limits to growth, does that justify government involvement in reproductive decisions? How would you relate Daly's argument to Hirsch's?
3. Is Sagoff right to define environmental issues as essentially political and spiritual rather than economic?
4. It has been joked that at prevailing discount rates, today the net present value of Armageddon in 2200 would be about the price of a six-pack. Can markets effectively allocate resources over time? Can governments?
5. What might Sagoff say of Posner's analysis? Do you agree?

#### **D. Conclusion**

##### **Thu 12/6 Failures of Government**

James Buchanan, "Rent Seeking and Profit Seeking."\*

Greg Rushford, "Don't Bother to Compete; Hire a Lawyer," *WSJ* 9/21/95.\*

As we intimated in the last study question on Milton Friedman, liberal theorists are skeptical that government officials necessarily act according to some broadly conceived general interest. They argue that we should assume that public officials act according to their narrow self-interest, just as businesspeople and consumers are usually assumed to do. In addition, these "public choice" theorists maintain that the problem of "government failure" is often more acute than the problem of "market failure" that the government intervention seeks to cure. For the concluding class, we have assigned a short piece by another Nobel Prize-winning economist, James Buchanan (and a snippet from the *WSJ* that shares his ideas). The question on the table is whether these readings pose a decisive challenge to the various critics of liberalism we have studied in the second half of the course.