

WHAT WAS ‘NEW’ ABOUT NEOLIBERALISM?

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Abstract

This article advances an interpretation of the core contribution of neoliberalism to the liberal tradition. At the hands of neoliberal thinkers, the classical liberalism of Locke, Smith and Mill underwent a reconstruction involving certain re-conceptualisations of individual and political freedom, which served to shift the crux of the case for classical liberalism from market success propositions to government failure propositions.

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1. Introduction

This article is concerned with the nature of ‘neoliberalism’, that great swing of the ideological pendulum, pivoted on economic thought, which was set in motion in the late 1940s by Milton Friedman, F.A. Hayek, James M. Buchanan and Ronald Coase, among others.¹

The point of departure of the article is the question: what *kind* of thing was neoliberalism? Was it a certain *programme of policy*, as many commentators appear to take for granted? Or is it better identified as an *episode of intellectual development*? And if it is better identified as intellectual development, can it be deemed an episode of objective progress or insight? Or was neoliberalism fundamentally creedal, ‘ideological’ and extra-scientific? Was it itself essentially normative and value-based, turning, above all, on an elevation of freedom? Or was it, at bottom, a *positive* critique of the unreal and idealised assumptions about processes of government commonly made in mid-20th century economics?

Finally, if neoliberalism did indeed constitute an episode of objective intellectual progress, was it no more than a ‘clarification’ of a two-centuries-old tradition of liberal thought – as neoliberals sometimes modestly maintained – or did it amount a radical reformulation of traditional liberalism that, by usurping the primacy of the political with the economic, amounted to an ‘invasion of politics by economics’?

This article contends that neoliberalism should be understood as a piece of intellectual growth, and not simply construed as a programme of policy. It was a policy programme, certainly, but neoliberalism was much more than some sort of twentieth-century Anti-Corn Law League. Neoliberalism, in the view of this article, constituted a genuine intellectual growth that revised both normative and positive aspects of historical liberalism, with a strengthening effect on the liberal tradition. More particularly, the core of the intellectual growth of neoliberalism lay, it is argued, in certain re-conceptualisations of individual and personal and political freedom that served to shift the crux of the case for classical liberalism from vulnerable ‘market success propositions’ to more secure ‘government failure propositions’.

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The article makes the case for all the above by proceeding historically. It begins with a schema representing the doctrinal structure of 'classical liberalism'. It then stresses how the 'historical liberalism' prevailing in the nineteenth century relied on the economic and social thought of the Enlightenment to argue for the adhesion of the structure of the component elements. The article then explicates how this case for the structure's internal adhesion lost its cogency from the last half of the nineteenth century, leaving classical liberalism in crisis by the mid-twentieth century. The article goes on to introduce the attempt of neoliberalism to face this crisis by drawing attention to some 'roads not taken' by neoliberalism. It finally turns to articulating the neoliberal reconstruction of liberalism that replenished the force of classical liberalism in the post-war Western world.

2. An anatomy of classical liberalism

'Classical liberalism' is taken here to be a train of thought, recognisable from the eighteenth century, that upholds a certain compound of normative values and positive propositions. Its leading values may be taken without controversy to be freedom, wealth and reason.² A nominal adherence to these values is fairly widespread in the West today; but they were obviously antithetical to the leading values of pre-modern or *ancien regime* societies – say, structure, honour and continuity.

In that 'values contest' of more than two centuries ago, classical liberalism was assisted by the development in the eighteenth century of a set of positive propositions about human nature and 'the world' that disposed of a danger that lay in the plurality of values of classical liberalism, namely, the danger of conflict between these values. Eighteenth-century economic and social theory suggested there was a mutual 'valency' between elements of the triad, the three value atoms form a molecule – they hang together and constitute allies.

Thus, classical political economy maintained that freedom promotes wealth; this is the famous Smithian proposition, and perhaps the strongest proposition of classical liberalism. But beyond that it was also held (in the minds of Montesquieu and Hume) that wealth was nurturing of rationality.³ Beyond that, in turn, it was held that rationality was productive of freedom. That 'thinking for yourself' is a precondition for true freedom is a prominent theme of several classic statements of the liberal outlook, including Kant's *What is Enlightenment?* and Mill's *On Liberty*. Additionally, this notion in its negative form – that irrationality aids and abets authoritarianism – was at one with the Enlightenment belief in the culpability of 'superstition' in arbitrary government.⁴

Thus, there was a link running from freedom to wealth, from wealth to reason, and from reason to freedom. Further, eighteenth-century economic and social theory presupposed links running in the other direction. Thus, a Humean theme is that freedom fosters reason in the competition of ideas, and was later formulated as a well-known Millian proposition of the foundation of right belief on their contestability⁵. Classical political economy reinforced that link by supposing that the free market would materially reward rationality. That reason is productive of wealth is presumably an uncontentious linkage; while the proposition that wealth is productive of freedom was also entertained: Smith is very plain in tracing the decline of feudal ruling structures to an increase in wealth (Smith 1776, III.4.15).

The clinching illustration of the mutual adhesion of the values of freedom, reason and wealth is the market. And Smith's 1776 analysis of speculation in the grain market (Smith 1776,

IV.5.b), whereby foresight and freedom produce everyone's betterment, is an exemplar. His 'invisible hand' metaphor expressed more abstractly 'the categorical market success' proposition that became central to historical liberalism. Here lay political economy's great gift to liberalism: it provides the concrete and argued exemplar of the coherence of the triad. It is no accident that among those most successful in resuscitating liberalism – the neoliberals – were those most alive to this gift, namely, economists.

This mutual adhesion of liberalism's three values amounts to a 'package deal'; one comes with the others. While that does not by itself *recommend* those values, the mutual adhesion must have been good news for classical liberals; it must have animated them, just as a mutual conflict would present paralysing dilemmas. And the mutual adhesion meant that 'semi-liberals' – those who value only one member of the triad – would value the remaining members instrumentally.

Reinforcing the instrumental valuation of certain liberal values was the apparent coherence of the triad with other values. By the opening of the nineteenth century it appeared that there existed still larger 'value molecules' that were stable. It appeared that the triad possessed a valency with humanitarianism, as liberalism could make powerful common cause over humanitarian issues (such as the coalition between the British and Foreign Anti-Slavery Society and political economy over slavery that so maddened Thomas Carlyle, and was personified in Henry Thornton). The triad possessed a valency with order that would gratify conservative-liberals (a T. B. Macaulay); a valency with equality that would gratify radical-liberals (a Henry George); even distributive justice (a J. B. Clarke). Thus in the nineteenth century classical liberalism drew strength from the muster of such hyphenated liberals. These hyphenated forms seemed to open the possibility of a society that was not only free, rich and enlightened, but also humane, orderly and equitable; a virtual escape from any 'value compromise'.

Little wonder that 'historical liberalism' – the justification for the adhesion of the value triad by the Enlightenment arguments cited above – had, by around, say, 1870, seemingly won the world.

3. The decline of historical liberalism

Or so it seemed. Within the space of a lifetime historical liberalism had come to look as much a Victorian relic as the ear trumpet. What happened?

First, the very triumph of classical liberalism undercut the 'hyphenated liberalisms'. To illustrate: in the reaction to the fall of the *ancien regime* in France there had germinated doctrines which disputed the conservative-liberal belief in the valency of order and freedom, and which branded liberalism as a philosophy of disorder (see Coleman 2002, ch. 2). The issue of this reaction was ideologies of hierarchical collectivism, from which 'fascism' ultimately drew some energy. In parallel difficulties, the apparent congruence between *equality and freedom* and *humanitarianism and freedom* was undercut by the impression in the nineteenth century that the newly triumphant the liberal order was simply replacing old sources of inequality with new sources, and old inhumanities with new inhumanities.

Second, and more important, liberalism was from the latter half of the nineteenth century menaced by the spread of a democratic criterion as a touchstone of judgement of the rightness of things. This left liberals nonplussed on account of the kinship that liberals

perceived between democracy and collectivism. And their perception was logical, at least according to the common conception of 'democracy' of the day. In this conception democracy was the articulation of the general will by means of majoritarian institutions. Such 'democracy' is highly akin to collectivism; all legitimacy is based on a majority decision. Everything, directly or indirectly, seems to properly occur only if licensed by a majority. This appearance of an offending kinship would be reinforced by the inauspicious correlation, from the latter half of the nineteenth century, between the extension of the franchise and the strengthening of collectivism: an extension noted in retrospect with some satisfaction by socialists (Durbin 1945).

The arrival of political democracy, in summary, exposed a pre-existing ambiguity in the liberal value of freedom: was it a matter of 'free persons' or of a 'free people'? The apparent conflict between the two seemed to make necessary a choice between classical liberalism and democracy, and the choice was not favourable to classical liberalism.

There was a third – the most important – cause of the decline of classical liberalism: the apparent loss of valency between elements in the value triad. Of the various valencies the most secure would seem to be that between reason and wealth. But even this valency had a possible and increasingly plausible characterisation that was antithetical to liberalism: the 'Conquest of Nature' world view (see Coleman 2002). In this view of the world, society's problems were traceable to its ignorance as to how to manipulate and direct the natural world, and that ignorance would be conquered by scientific method. The upshot was that the natural sciences would be the necessary and possibly complete proximate solution to the world's problems.

During the nineteenth century the Conquest of Nature paradigm seemed to receive a vivid vindication from the scientific, technological and industrial revolution of that period. Science's new 'powers' (steam, electricity, petroleum) were obvious; but perhaps the most powerful (apparent) exemplification was the public-health revolution of the late nineteenth century, whereby science understood the dreadful problem of infectious disease and scientific management of sanitation largely disposed of it. And, as this seeming vindication was contemporaneous with the burgeoning of socialism, the Conquest of Nature paradigm was largely adopted as socialism's theory of *how* socialism would secure its promised benefits. This theory was soon put to work, as Veblen's (1921) vision of rule by engineers was rather literally realised in the Soviet Union.

By the 1930s, then, science, rationality and enlightenment appeared to be on the side of 'social engineering', 'scientific management' and 'planning'. Thus, *the rationality that was complementary to welfare was hostile to freedom*. And to stickle for freedom was to spurn enlightenment. Beyond the vivid cases of Haldane and Bernal, the outlook is characteristic of the influential interwar figures of Dewey and Beveridge (Harris 1997, ch. 12).

This prospect of a successful assertion by anti-liberals of the values of welfare and rationality was made still more dangerous for classical liberalism by developments in economic theory of the early twentieth century that seemed to countenance this assertion. The most pregnant of these developments was the understanding that the optimum of any economy (be it capitalist, socialist . . . or whatever) was a matter of the satisfaction of a set of conditions involving marginal concepts (such as 'marginal cost') that could be stated in terms of 'objective' (observable) categories (see e.g. Barone 1935). But, critically, economic theorising of the interwar period concluded that the 'invisible hand' would not secure the satisfaction of these

conditions.⁶ As the twentieth century approached its midpoint, the Smithian doctrine – the maximal promotion of the general welfare through the pursuit of the private good – was subverted by the conclusion that the rational actor in the context of the free market would be not efficiently serve economic welfare.

Thus, the imperfect competition revolution of the 1930s had – as Schumpeter and Nichol (1934, p. 251) put it – made fallacies of old theorems of optimal allocation by the market system. Additionally, Harold Hotelling (1938, 1939) argued that in important circumstances not even the competitive market would yield socially efficient marginal cost pricing. To the same ultimate end, A.C. Pigou as early as 1912 had aired the contention that the marginal cost pricing that was achieved by the market would frequently be socially inefficient: the free market overproduces ‘bads’ because the beneficiaries of some activities do not pay for all the negatives those activities involve. Repeated editions of his *The Economics of Welfare* (1920) expanded the thought, and by the 1930s the problem of externalities was a commonplace critique pressed with vigour by market critics (e.g. Durbin 1935). The upshot of this theorising was that the rationality of ‘the margin’ was turned against the market, with Oskar Lange (1937) driving a stake through its heart by pronouncing that desirable marginal cost outcomes could be secured only under socialist planning.

Compounding the difficulty, classical liberalism’s supposition of congruence between freedom and wealth was badly damaged in the interwar period at an ‘economic system’ level. The congruence of freedom and wealth in macroeconomic terms received a massive blow from the Great Depression; and that wound was reinforced by Keynesian macroeconomic theory. In the Keynesian theory of national income there was, indeed, an acute incongruence between freedom and wealth: we would all have higher incomes if we were all compelled to consume £1,000 more than we would freely choose. The case for Keynes’s contentions ultimately lay in his repudiation of the classical economists’ belief in a synergy between freedom and reason in the generation of wealth. Keynes believed unemployment was ultimately founded on the fact that human foresight was not (in general) capable of the performances in asset markets that orthodox economics presumed it was equal to; that any isolated patches of the foresight envisioned by orthodox economics would be injured, rather than rewarded, by asset markets;⁷ that the most common species of foresight was a foresight of the *vagaries* of human judgement, and that this foresight fostered only harmful instability in asset prices; that in such a world of hazardously low visibility the money asset took on the function of a ‘security blanket’; and the clutching of that blanket prevented the investment necessary for full employment and thereby took away natural scarcity, so overthrowing the rationality of orthodox economic policy. And so – to epitomise the matter – whereas Smith had said what was prudence in the household could only be prudence in a great kingdom, Keynes implied that it would be prudent for a great kingdom to hope for imprudence in its households.

The outcome of all this was that economics, which had provided the exemplar of the congruence of the elements of the triad, now seemed to teach their incongruence. The incongruence was not only painful but raised difficult questions that could previously be avoided: do you want to be free if it means being poor? Could anyone say?

Little wonder that when in 1947 Hayek called the first meeting of the Mont Pelerin Society it was to devise a ‘new version’ of liberalism that would ‘come to terms with certain real problems that had either been ignored or shirked’ (Hartwell 1995, p. 33).

4. Alternative liberal revivals

Reformation projects are commonly beset by two forces pushing in different directions. The two forces could be formulated as ‘complicating’ and ‘simplifying’ strategies; but perhaps ‘adding colour’ and ‘increasing contrast’ might capture the distinction better.⁸

In the context of the ‘reformation’ of liberalism, the ‘strategy of complication’ is crystallised in the contention that that the triad will survive and perform its feats only *when set in a social and ethical context*: when ‘the market’ is implanted in a certain net of mores, when the values of the triad are supported by other values.

The most vocal representative of this tendency of thought was Wilhelm Röpke (1899–1966), who played a key role in the foundation of Mont Pelerin Society, and who may be said to represent a road ultimately not taken by neoliberalism. In the 1930s Röpke had established himself as an adversary of collectivism and corporatism (see Gregg 2010). But in his *Social Crisis of Our Time* of 1942, he advanced a critique of what he called ‘historical liberalism’. The ‘catastrophic mistake’ of historical liberalism was ‘to consider the market system as something autonomous, something based on itself, as a natural condition outside the political sphere requiring no defense or support, and to overlook the importance of an ethical, legal and institutional framework’ (1950, p. 118). Without this framework the ‘political, economic and rational’ goals of liberalism (i.e. the value triad) would be prey to certain inevitabilities in human nature. Indeed, they would fall prey to each other, claimed Röpke, repudiating the valency of the triad.

Röpke’s sense of the imperative to base classical liberal values on ulterior moral standards necessarily made conditional propositions of the claims of classical liberalism, and it thereby had a ‘cautioning’ and moderating influence on those claims. But it would be wrong to see his thought as amounting simply to a middle position on the conventional political spectrum (a bit of market, a bit of regulation . . .). Indeed, on a conventional ideological spectrum Röpke’s thought would be classified as ‘conservative’ on account of its emphasis on moral capital at the expense of the physical capital that classical liberals rely on: an emphasis whose logical terminus was Röpke’s conviction of the centrality of religion to human existence. For all that, Röpke’s ideas were also resonant of the left ‘social liberalism’ of the first half of the twentieth century, which held that ‘mutual aid’ was an essential complement to freedom. Indeed, the German policy mix that Röpke was associated with was dubbed ‘social market liberalism’.

An impulse of potential reformation that pressed in an opposite direction to Röpke’s was provided by Ludwig von Mises (1945, 1949, 1962). This was an impulse that turned not on ‘broadening’ but ‘sharpening’; an impulse that would recoil from any appearance of meeting liberalism’s adversaries halfway, or a quarter of the way, but seek to defy them by sharpening the incongruence of liberal tenets with those of their adversaries, and to model liberalism on the negative image of its most fatal adversary, Marxism. So, since Marxists had an avowed ‘objective’ theory of value, liberals should insist on an exclusively subjective theory of value. And as Marxists had favoured (until then) a positivist methodology, liberals should champion an extravagant a priorism (Mises 1949). As Marxists stress conflict, liberals should make a precept of harmony (Mises 1962). If the labour market is that which is most offensive to socialists, then to classical liberals the labour market must be the *sine qua non* of any economic system. If to Marxists all value comes from labour, then make capital accumulation the focus of all hope (Mises 1945; 1962). If Marxism vaunts the mass and dismisses the individual, then

liberalism must exalt the individual and scorn the populace. If socialists preach brotherhood, then despise fraternity and extol selfishness (Burns 2009).

This might be dubbed an ‘anti-social market’ liberalism. It could alternatively be dubbed ‘radical’ or ‘extreme’ liberalism.

While a rhetorical power lies in this strategy of liberalism fashioning itself in the negative image of Marxism, the outcome of the strategy had little to do with neoliberalism or, I would contend, classical liberalism. Philosophies of egotism, philosophies of the omnipotence of the human intellect, philosophies of the power of the tool – these have recurred since the Enlightenment, but they are not part of liberalism. They are, in fact, hostile to it. The strategy of contrast, I suggest, is not so much fortifying of the contested redoubt as weakening of it.⁹

But did the alternative ‘value broadening’ strategy offer much more by way of useful reformation? There were some promising precedents in liberal thought. The ‘sociological move’ had been sensitively explored by Tocqueville. And Röpke’s ideas had parallels in the thought of some liberal sympathisers in his own day. Walter Lippmann’s *The Good Society* (1943) shared his yen to supplement the market with some source of order outside statute law. Röpke’s pessimism about the coherence of the triad resonated with Michael Polanyi, another Mont Pelerin participant, who was arguing that an unfastened rationalism would devour all values, including freedom (M. Polanyi 1946).¹⁰ Schumpeter (1943), in a more specifically economically vein, had argued that rationalism would ultimately destroy the entrepreneurial capitalism he so admired.

Yet for all the sense of promise, Röpke’s own performance could be described as ‘all manifesto and no model’. The work to explicate and theorise his claims wasn’t done. And there was work to do. For broadening the value set of a social philosophy comes with an obvious danger; intending to achieve a value-complementarity, it can end up contriving a value-conflict. This danger is especially acute for liberalism on account of the centrality it gives to freedom; for freedom doesn’t allow much space for the moral claims that additional values would bring with them. Part of the very import of freedom is its trumping of such moral claims. Insofar as we deny that trumping, we seem to drift away from liberalism. To illustrate: Röpke’s hostility to many concrete manifestations of capitalism – his quest for a ‘just relation between performance and pay’; his agrarianism; his stand as ‘cultural critic of capitalism’ – seems hard to square with classical liberalism. It is not a surprise that Röpke acknowledged that he ‘never felt quite comfortable in the company of “liberals”, even when styled “neoliberals”’ (Röpke 1960, p. 92).¹¹ Neoliberals shared the discomfort. Milton Friedman and George Stigler deemed Hayek’s *Constitution of Liberty* a ‘far stronger candidate’ to represent the Mont Pelerin Society than Röpke’s *A Humane Economy* (quoted in Hartwell 1995, p. 229). In private communication with Stigler, Friedman expressed his disesteem of Röpke more frankly (Hammond and Hammond 2005, p. 131). This doctrinal tension surely underlay the split in the Mont Pelerin Society in the early 1960s between an Anglo-American tendency (Hayek, Friedman and Stigler) and a continental tendency: a split that ultimately produced Röpke’s resignation (see Hartwell 1995).

5. The reconstruction: freedom and democracy

What, then, was the path actually taken by ‘neoliberalism’ to circumvent the crisis of classical liberalism?

In the interpretation advanced in this article, it developed the key concept of freedom so as (a) to reconcile it with the leading political current of the day – democracy – and (b) to re-forge its link to the leading non-political concern of the day – an effective economy.

With respect to the first, neoliberalism achieved a fundamental reorientation of classical liberalism towards democracy: from (at best) an oblique relation to being its truest champion, at least in its own mind. The key innovation was provided by James M. Buchanan and public choice theory, which broke the apparent kinship between collectivism and democracy by repudiating the conception of democracy as the articulation of the general will by majoritarian institutions. Classical liberals had always shrunk from such ‘Asiatic democracy’, as Tocqueville dubbed it (Tocqueville and Senior 1872, p. 186), but seemed at a loss to advance their own conception of legitimate mass collective action. Public choice did so, drawing on economics. To public choice, democracy is no more than a system of competitive ‘political markets’: democracy is the political analogue of the competitive market.

The legislature is not the oracle of the general will, the temple where that will is divined; nor is it a parade ground where that will is marshalled and mobilised, or the jury room where that will is formed; and neither is it the congress of opinions sought by John Stuart Mill. Buchanan was, then, rejecting the ‘Athenian’ vision of democracy, which had appealed to liberals in their attempts to arrive at a congenial conception of democracy, and which had been advocated by Knight and Simons in their 1930s formulation of ‘democracy as discussion’ (Simons 1948), and by Popper in his formulation of democracy as criticism and experiment (Popper 1945). No; to Buchanan the legislature is a marketplace, where different political constituencies trade with one other for their mutual benefit (Buchanan and Tullock 1962).

And in this marketplace there is no special grace about the majority as a precondition for collective action; the majority is simply one possible *price* of collective decisions, among many possible prices; and as a price a majority may be a promiscuously low price (too many collective decisions) or possibly a prohibitively high price (too few collective decisions). If the majority has any special merit, it is actually to secure the ‘cycling’ that social choice theorists of the 1950s found so awkward: to secure the rotation of power between the ‘inconsistent’ and antagonistic particular ‘wills’ that compose the electorate (Buchanan 1954).

In as much as public choice adheres to the notion of the general will in democratic politics, it removes it to ‘the constitutional phase’ – that is, the constitution-building aspect of political existence – where there will presumably be unanimity on the desirability of placing constitutional restrictions upon the prerogative of the majority in the *post*-constitutional phase, in order head off exploitations in favour of majorities. Thus, the constitutional phase of democratic society would in some measure thwart that exploitation of the state by special interests that made Röpke and ‘Ordoliberals’ so anxious about the democratic polity.

The upshot was that public choice disencumbered liberalism of its suspicion of democracy ‘correctly interpreted’. At the same time its economic interpretation of politics when applied to *government* fuelled suspicion of government. After all, government was a monopoly (a ‘monopoly of force’), and what did liberals think of monopoly? Thus, whereas throughout the twentieth century economists in the Anglosphere had been wary of democratic politics but hopeful of government, public choice would have them wary of government but hopeful of democratic politics.

Going beyond the reconciliation of democracy with liberalism was the assimilation by neoliberals of any free political life to liberalism. The proposition is put most concretely in Friedman's defiantly named lectures *Capitalism and Freedom* (1962), where he reaches towards an equivalence of political freedom and economic freedom. He argues that economic constraint and political constraint are equivalent; would not controlling the issue of passports and controlling the issue of foreign exchange come down to the same thing? In the same spirit Coase, in his massive studies of public sector communications, recurs to the infringement of political expression by government monopolies: his case in point is the feud between John Reith and Winston Churchill, and the BBC's refusal to give a microphone to Churchill in 1930s (Coase 1947; 1954). Coase later trialled the notion that the case for free markets is the same as the case for free speech (1974). This possibility had been expressly rejected by Mill in his *On Liberty*.¹² The neoliberals were rejecting what many people – including Mill – accepted: 'the polity is one thing and the economy is another': a political domain where there is one appropriate criterion (say, obligation and command), and an economic domain where there was a completely distinct criterion (say, choice and exchange). Such a sense of a single domain is suggestive of the thought that to choose 'command' in economy is to come down to choosing 'command' in politics. Here we come to Hayek's stern counsel of 1944 to the Western public that it could not pick and choose between command and exchange, but had to 'make up its mind'. *The Road to Serfdom* pronounced that 'democratic collectivism' was a mirage: an impossibility, at least in the long run. The public consequently had only two ultimate choices: dictatorship or some kind of liberalism. Hayek's case for these contentions may have been incomplete, but the upshot of Hayek was clear: political freedom was not just assimilated to economic freedom, it owned it.

6. The reconstruction: freedom and wealth

Not only did neoliberalism seek to make peace between the older value of freedom and the new value of democracy; it also sought to restore the old valency between freedom and wealth. The crucial valency was strengthened by developments in economic theory at the micro level that pressed back against 'market failure' theorising with 'market success' counters. From the 1950s imperfect competition was criticised as empirically insignificant by Chicago economists, and apparently exploitative business practices were rationalised as socially efficient adaptations.

Further to the same end, Coase provided a critique of Pigou by pressing the potential for both contract and property rights to prevent the market's overproduction of bads (Coase 1959, 1960). Coase argued that the 'victim' of any overproduction of bads had every financial incentive to bribe the 'offender' to not perform any socially costly action, at least in bilateral encounters. And if the multiplicity of 'victims' made it costly to contrive the appropriate aggregate bribe, then affording each victim a tort remedy would be just as effective.

To the same end, the pretensions of 'market socialism' to outperform 'market capitalism' in social efficiency was subjected to a critique by Hayek (1941). To Hayek it was merely a false cognitive rationality ('scientism') and a false instrumental rationality ('constructivism') that implied that the enlightenment that was complementary to welfare was hostile to economic freedom. Constructivism meant the belief that anything worth having – including the economy

– must be planned (or designed). And scientism added that the only knowledge the economic planner had to work with – ‘data’ – was the only kind of knowledge worth having. Hayek’s counter to scientism was that a crucial part of knowledge is private, non-verifiable, non-observable and to some degree non-communicable. This is not data, and cannot be used by the planner. It can, however, be absorbed by the market, as the infinitely dispersed concrete knowledge of billions of people – along with their hunches, intuitions and weird insights – impact on market prices. The upshot of Hayek’s critique of scientism and constructivism was that, by breaking the apparent bond between reason and planning, it deflected the reason that would make freedom an impediment to wealth.

Beyond the microeconomic case for economic freedom, Friedman on a macro level had defanged this implication of the Great Depression (and so the warrant for the Keynesian Revolution) by blaming its depth not on the market, but on the Federal Reserve and central banking (Friedman and Schwartz 1963, p. 301). In doing so he was putting the blame on what was (of course) an attempt to supersede the market, and indeed to tame ‘the bank run’: central banking.

It is Friedman’s work on the alleged delinquency of central banking in the Depression that provides a cue to introduce the key summarising departure of neoliberalism from classical liberalism: ‘government failure’.

7. Government failure, not market success

It would be wrong to think that Friedman’s case against central banking amounted to the contention that central banking took something good (the market) and made it bad. That was not his position. To Friedman active monetary policy *could in certain situations do good*; the competitive system wasn’t always maximising, there was a ‘market failure’ (e.g. bank runs). The problem was that the central bank did not correct these failures; it mismanaged interventions that could be managed improvingly. Thus, his criticism was not pinned on a *perfection of the market* but on a *defect in government*.¹³

We are led to the thought that the neoliberals’ contribution was to shift the burden of the case for liberalism *from market success to government failure*.

Since the time that Smith declared that the market (by an invisible hand) enlists one and all to make the ‘annual revenue of society’ as great as it could, historical liberalism had in large measure rested on claims that the unregulated market would reliably maximise the economic good: claims that are here called ‘categorical market success propositions’. But by the mid-twentieth century, categorical market success propositions could not provide the requisite soldering between freedom and wealth. For all the neoliberals’ celebration of the market, and for all their push back against oversold 1930s critiques of the market, market failure propositions were here to stay. Thus, neoliberals accepted the phenomenon of public goods that Samuelson had starkly clarified in the 1950s. Indeed, they used the phenomenon in spite of Coase’s and Buchanan’s reservations regarding the Samuelsonian concept, and in spite of later work on ‘multi-part pricing’. In the same vein, while ‘Coase’s Theorem’ (Coase 1960) may in the eyes of its partisans amount to a dazzling market success proposition, it remains debateable whether Coase’s insight demonstrates that the market will always fully align private and social cost. Finally, if Hayek’s invoking the market’s ‘information’ function served to refute ‘market socialist planning’, the market–information nexus has not proved an enduring success for the

market advocate, as information issues have since the 1960s proved a happy hunting ground for market failure hunters.

The pure market outcome, then, could not be the best of all feasible worlds to neoliberals. So why reject shifting that outcome by some ‘economics of control’ (Lerner 1944)? To plead the incapacity of the state to make a perfecting shift is beside the point: the *dirigistes* hardly need the state to be capable of a *perfecting* shift to make their case; an improving shift would be sufficient. And to plead the incapacity of the state to make an improving shift of even a small degree would be implausible. The inevitable bungling and ignorance of government will not convict the state of such complete incapacity. Its bungling and ignorance does not (after all) imply that laws against theft are worse than useless: so why should it necessarily imply that laws against (say) monopoly pricing are worse than useless? For all its inevitable bungling and ignorance, surely government action in the face of market failure can make things at least marginally better?¹⁴ As Friedman insisted, while the Federal Reserve System could not have prevented a recession in 1929, it could have prevented a depression.

It was in the response to this query that the key innovation of neoliberalism lay: it was not that government *could not* intervene improvingly, but that government *would not*. To illustrate: government has the potential to play a useful role in establishing and defending useful property rights. It could establish rights such that railways would not destroy crops to the detriment of social income. But it has not always chosen to do so; it has instead, says Coase, chosen to extinguish or truncate such useful property rights (Coase 1996, p. 112).

This phenomenon of the state choosing not take socially maximising actions that it could take is the notion of *government failure*, and the significance of government failure is a key contention of neoliberalism. But how were neoliberals to justify such a contention? Neoliberalism clearly required a theory of government behaviour. As it happens, this fundamental requisite of neoliberalism came rather late in its history. But by 1980 two models of government failure had been investigated and articulated.¹⁵

1. *The exploitation model* (e.g. Brennan and Buchanan 1980). Government stands in relation to the public as a farmer does to his herd; the government milks the public as best it can. Thus, government doesn’t act in the public interest because it is not interested in the public interest.
2. *The inability to commit model* (e.g. Kydland and Prescott 1977). Here the seed of failure lies not in any antagonism between the interest of government and the interest of the public, but in the fact that the two are unable to contract. This inability means government is not bound to meet its commitments to the public, and has, in effect, licence to deceive it. The significance of this is that by such deception government can secure resources for public-spirited government activities that do not impair incentives to the extent that (say) ordinary, foreseen taxation would. However, the public won’t be deceived, and deception cannot be an equilibrium. This implies that the social benefit of deception must be eliminated, and that can be achieved only by the public’s circumstances being so reduced – made sufficiently ‘urgent’ – that the transfer of resources to the government, even for beneficent government activities, is no longer improving.

Both these models carry insight. Both are also question-begging, partial and delimited in application. Rather than pursue these defects, it would more germane to the task of this article

to stress that these two theories of government failure have an affinity with the conceptions of freedom that were developed by Hayek and Buchanan.

The most common way of conceiving of freedom is, surely, as the absence of constraint. But this concept is not very useful to classical liberals, as it is vulnerable to critique from the Right and to misappropriation by the Left. For if 'constraint' is taken in a narrow legalistic sense, then the most perfect freedom is anarchy, and we are left with Burke's conservative mockery of liberalism: 'Am I to congratulate a highwayman and murderer, who has broke prison, upon the recovery of his natural rights?' (Burke 1964, p. 6). But if we are not to take constraint legalistically, but extend its reference to include all sorts of checks and limits on our capability, then we open a straight road to state action serving freedom (or 'positive freedom') through its expanding the boundaries of our capability.¹⁶

The innovation of neoliberals was to reject any simple inconsistency between 'constraint' and 'freedom'. Some constraint is inconsistent with freedom, but some constraint was consistent with it. The task was to identify and delimit that constraint that was inconsistent with freedom. On this Hayek and Buchanan offered distinct answers.

What offends Hayek is *manipulative* constraint, or coercion (Hayek 1960). What Hayek wants is the absence of is manipulative constraint. An individual is free insofar as the constraint is not imposed with the intention of securing a particular result from that particular individual.¹⁷ What offends Buchanan is *unchosen* constraint (Buchanan 1991). To Buchanan freedom amounts to the presence of chosen constraints. And to 'choose' a constraint strongly intimates unanimity, which in turn implies the 'constitutional phase' in the public choice conception. So freedom amounts to constitutionality.

Clearly the presence of manipulative constraint and absence of chosen constraint coordinate with the government failure associated with the inability to contract, and the resulting manipulation of the public by government. It is also clear that the presence of manipulative constraint and absence of chosen constraint resonate with the government failure-associated exploitation model. Thus, government failure is not simply not achieving outcomes in the public interest that government could achieve; government failure also constitutes offences against freedom, properly conceived. Freedom and wealth are soldered without categorical market success propositions.

Finally, this last – this discarding of categorical market success propositions – also permitted a new vision of the liberal state (that is, the freedom-heeding state). In the neoliberal vision the state is not inert or absent; it is not the night-watchman state suggested by classical liberalism and 'market success' propositions but a *rule-bound* state; one encumbered by a constitution, and unendowed with a perpetual hunting licence to shoot 'problems'.

8. Conclusions

This article has advanced an *histoire raisonnée* of the transformation of historical liberalism into neoliberalism. It has identified the crisis of historical liberalism as arising from its lack of a legitimising theory of democracy in an age of democracy, and from the threats to categorical market success propositions posed by twentieth-century developments in economic theory. The article has argued that neoliberalism reworked the understanding of individual and political freedom in ways that promised to restore the cohesion of freedom with both economic success

and democracy, and thereby restored its potency as a solvent of collectivist solutions and presumptions in the post-war period.

Notes

1. The term 'neoliberalism' is, of course, most frequently in the mouths of its detractors. In this article it is used non-pejoratively, as the least inconvenient umbrella term for the correlate, if distinct, strands of thought pioneered by these four authors. Regrettably, lack of space prevents the 'locating' of Ordoliberalism with respect to neoliberalism. There is a clear affinity between Ordoliberalism and the thought of Wilhelm Röpke, who does figure in this article, but doing justice to that affinity would require even more space.
2. These are surely not the only values a classical liberal will hold; but a classical liberal will maintain that these three 'trump' any others.
3. See the 'doux commerce' thesis of Montesquieu and of Hume (1987, p. 115). Hume disavows any mechanical linkage between wealth and the arts and sciences.
4. 'Superstition riveted their chains' (Gibbon 1776, IX, 53).
5. 'The beliefs which we have most warrant have no safeguard to rest on but a standing invitation to the whole world to prove them unfounded' (Mill 1982, p. 81).
6. The developments of these benchmarks that seemed to fail the market arose 'paradoxically' on account of neoclassical economists of the late nineteenth century having provided a far better 'case for the market' than the classical economists had ever done. But 'better' means explicit and deductive; and 'explicit and deductive' means vulnerable to criticism. The third generation of neoclassicals began to probe the vulnerability of the case.
7. 'I have reluctantly reached the conclusion that nothing is more suicidal than a rational investment policy in an irrational world': a comment attributed to Keynes by Hettinger (1963, p. 810).
8. Of course, other moves were possible. A reformulated liberalism could have sought to disarm collectivism by reclaiming equality as a liberal value, and go on to make common cause with the Left in establishing an equitable tax system and in battling 'the corporation'. This strategy was aired by Henry Simons, the standard bearer of Chicago in the 1930s (Simons 1948). We know this strategy was not pursued.
9. It is on this ground that this article excludes post-war Austrian economics from the phenomenon of 'neoliberalism'.
10. Röpke's rejection of 'science without conscience' coheres with Polanyi's aspiration to make something of a religion of the scientific enterprise.
11. The notion that the market requires careful embedding in society is, of course, central to the social doctrine of Karl Polanyi (1945), which has since served as a template for prominent anti-liberal frothings.
12. '... [T]he principle of individual liberty is not involved in the doctrine of Free Trade ... the so-called doctrine of Free Trade ... rests on grounds different from ... the principle of individual liberty asserted in this Essay. Restrictions on trade ... affect only that part of conduct which society is competent to restrain, and are wrong solely because they do not really produce the results which it is desired to produce by them' (Mill 1982, p. 164).
13. For this reason Friedman's 1960s critique of active monetary policy contrasts with Hayek's 1930s critique of active monetary policy. To Hayek in the 1930s, active monetary policy amounted to a price distortion; it reduced the market price of investment below the opportunity cost of investment, and as a subsidy it could only do harm. Thus, in the 1930s Hayek criticised activist monetary policy on *market success* grounds, whereas in the 1960s Friedman criticised activist monetary policy on *government failure* grounds.
14. See Friedman's review of the *Economics of Control* for his own acknowledgement that mere imperfection in the information of government does not rule out the possibility of improving intervention (Friedman 1947).
15. Friedman's own account of the government failure in central banking consists of no more than suggestive observations: a weak 'rule by committee' in the Federal Reserve in the 1930s, and, in the post-war period, the wish of central bankers to preserve their importance by churning financial markets.
16. Historically, the road was opened by J. S. Mill. His dictum that constraint on person X was inadmissible if its absence did not harm others soon transmuted into the precept that a constraint on X was admissible if its presence benefited others. All utilitarian welfare economics countenanced that proposition, up to and including the *Economics of Control*. Lerner prefaces one of his papers on socialist planning with a statement that is very much a profession of Mill's dictum (Lerner 1935, p. 152).
17. This conception has some harmony with Friedman's evident feeling that freedom consists of competition.

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