

## CHAPTER 2

### “LAISSEZ-FAIRE”: THE ECONOMIC LIBERAL PERSPECTIVE

#### Overview

Liberalism, like many other terms we use in IPE, suffers from something of a personality disorder. The same set of letters means different things in different contexts. In the United States today, for example, a political “liberal” is generally one who believes in a strong and active role for the state in society, helping the poor and solving collective social problems. Yet economic liberalism has come to mean almost (but not exactly) the opposite of this. Since the mid-1980s, someone who has been thought of more narrowly as an *economic liberal* believes *almost* but *not exactly* the opposite. For economic liberal (often referred to as neoliberals) the state should *play a limited* if not *constricted* role in the economy. In the United States, England, and some European nations, many liberals have much in common with those people and their political parties that are now referred to as “conservatives” in the sense that they focus mainly on sustaining individual rights, resisting state oppression, and preserving society’s traditional values and institutions.

This chapter outlines the liberal perspective on International Political Economy (IPE), linking the recent rise of the economic liberal view to its historical roots. We trace the broader idea of liberalism from eighteenth century France, through nineteenth century England, to the twenty-first century. Along the way we discuss some of the words of some of the most famous political economists, Adam Smith, David Ricardo, John Maynard Keynes, Friedrich Hayek, and Milton Friedman. Economic liberalism arose and evolved in reaction to important trends and events in the real world. Along its path to the present day, we will pause to consider the events that shaped this point of view such as the case of the Corn Laws, which illustrates the political economy of liberalism in the context of nineteenth-century Britain.

Note: An appendix to the chapter “The Market Model, Market-Based Resource Allocation, Economic Efficiency, Efficiency Vs. Equity,” appears in the IPE website: [www.upugetsoundintroipec.com](http://www.upugetsoundintroipec.com). It lays out the formal market model for instructors who want to explore some of the ideas, values, and methodologies of traditional formal rational choice oriented economists.

The chapter concludes with a discussion of the changing views on liberalism and economic liberalism in particular. It describes the difference between **orthodox economic liberals (OELs)** and **heterodox interventionist liberals (HILs)**. Globalization and the financial crisis of 2007 have both caused many officials and experts to question and even revise their beliefs about classic liberalism. However, due to entrenched beliefs, influential supporters, and various other reasons, economic liberalism itself continues to influence state policies.

The chapter’s four main theses are: 1) economic liberal ideas continue to evolve, reflecting changes in society; 2) the *laissez-faire* ideas of economic liberalism gained popularity during the *laissez-faire* Reagan and Thatcher administrations; 3) orthodox economic liberalism (OEL) has increasingly come under attack for its failure to sufficiently deal with such things as the financial crisis and poverty; and 4) although weakened, *laissez-faire* ideas and policies are likely to remain popular in many nations.

#### Learning Objectives:

- To identify and discuss the fundamental principles of liberalism and economic liberalism.
- To examine and discuss how these principles are illustrated in the ideas of Adam Smith and others.
- To explain why economic liberals fear concentrated power, in either the state or the market.
- To explain and discuss why economic liberals view individual action as a positive-sum game.
- To explain and discuss why economic liberalism differs from mercantilism.
- To identify and discuss the implications of economic liberalism for policy issues.

- To examine how the Corn Laws illustrate the conflict between mercantilism and the economic liberal ideas of David Ricardo.
- To discuss how the views of J.S. Mill and J.M. Keynes caused key changes in economic liberalism.
- To define the Paradox of Thrift and explain how it illustrates the failure of the invisible hand and the role of government in the market economy.
- To define the Keynesian compromise and how it is illustrated in the Bretton Woods system.
- To explain and discuss how the conservative views of Hayek and Friedman and the neoliberal policies of Reagan and Thatcher represent a backlash against Keynesian liberalism.
- To discuss the impact of the 2007 financial crisis and difficulties achieving recovery on neoliberal ideas.
- To discuss the status of liberalism today and why some theorists feel the popularity of economic liberal ideas and policies related to globalism and globalization have reached their zenith.
- To describe the emergence of heterodox interventionist liberals (HILs) and ordoliberalists, and to compare their ideas to those of classical liberals.

### Chapter Outline

#### ROOTS OF THE ECONOMIC LIBERAL PERSPECTIVE

- Liberals, in the classical sense used here, are not as sanguine as are mercantilists about the outcome of an active role of the state in the economy.
- They fear the heavy hand of government and seek to liberate the individual from state oppression.
- The broad term “liberalism” means “liberty under law.” Thus, all liberals believe in freedom, individual rights, and free markets. It is no accident that liberal and liberty have the same Latin root. Human nature is competitive in a constructive way and guided by reason, not emotions.
- Liberals believe that people are fundamentally self-interested but do not see this as a disadvantage because competing interests in society can be constructive.
- Classical economic liberalism is rooted in reactions to many trends in seventeenth and eighteenth century Europe. Classic liberals respect the market and the individual, often distrusting the state, concerned over its potential to abuse power.
- Francis Quesnay (1694-1774) led a group of French philosophers—the Physiocrats—who condemned government interference in the market. They adopted the motto *laissez-faire e laissez passer*—or telling the state “hands off” the economy.
- In his famous book *The Wealth of Nations*, Smith opposed mercantilism in favor of the state focusing on creating wealth, which produces more power and thus national security—another mercantilist objective!
- For Smith, the state is manifested in the Parliament, which until the 1830s was dominated by landed gentry’ interests that favored mercantilism. When power was redistributed to entrepreneurs and industrialists, economic liberal ideas finally took root. (See the Corn Laws box).
- Adam Smith believed in the cooperative, constructive side of human nature. He believed that the best interest of all of society is served by (rational) individual choices, which when observed from afar, appear as an “invisible hand,” that guides the economy and promotes the common good.

#### The Dominant Features of Capitalism

An overview of some of the ideas and tenets of capitalism based on Smith’s work.

- Markets help coordinate society’s economic activity by allocating resources given the tastes and preferences of individual consumers.
- Extensive markets exist for the exchange of land, labor, commodities, and money.

- Competition *regulates* economic activity; consumer self-interests motivate economic activity (individual self-interest serves society's interest).
- Freedom consists of free enterprise; individuals are free to start up new businesses without state permission.
- Private property gives the owner of a resource a legal entitlement to the income that flows from the resource.

Comments on these features include:

- a) The first three features deal with the nature and behavior of markets: products and services are commodified when producers set prices for them.
- b) Charles Lindblom explains how markets organize and coordinate society; markets determine our jobs and shape choices about travel, entertainment, and food.
- c) Karl Polanyi classic book *The Great Transformation* explains how and why markets require land, labor, and capital. Modern capitalism was born in the seventeenth-century when land in Great Britain was privatized and people moved from the countryside into industrial areas where they worked in small enterprises like woolen mills. This provided a financial foundation and labor for the industrial revolution.
- d) When economists say that competition regulates economic activity they are explaining how Smith believed that the pursuit of individual self-interest serves society's interest.
- e) In a capitalist economy individuals make rational-choices based on their needs and desires. But competition constrains and disciplines self-interest and prevents it from becoming destructive to the interests of others.
- f) Capitalism assumes that price competition results in the *efficient* allocation of resources among competing uses. Economic liberals believe that no one should be in charge of allocating resources, especially the state, should be in charge of that process. Resource allocation should reflect the tastes and preferences of consumers.
- g) Government intervention in the market distorts resource allocation.
- h) Competition compels corporations to be efficient, i.e., to adopt many cost-saving measures in order to compete with other producers.
- i) Competition requires many companies to adopt new technologies that decrease production costs or are attractive to customers in some way.
- j) The last two features deal with the role of the state in establishing freedom of enterprise and private property. Enterprises should be able to channel their goods and services to those who are demanding (willing to spend) for them.
- k) Individuals should be free to make their own career choice and take advantage of new opportunities when they arrive.
- l) Capitalists are usually adamant that the income of those who own capital is usually in the form of profits. Profit is what is left over after workers and providers of raw materials and services are paid. Whatever is left over is considered to be profit.
- m) When property is private, producers are motivated to make investments in improving their property and providing them with the collateral to do so.
- n) Freedom of enterprise allows owners to test new ideas and products in the market.

Smith, the Cynic and Moralist

- a) Although many view Adam Smith as an economist who believed in the rule of the *invisible hand* of the market above all else, his economic philosophy was in fact more complex.
- b) In a less famous book *The Theory of Moral Sentiments*, Smith appears to contradict some of his most famous orthodox economic liberal ideas.
- c) In the case of his views of the state, Smith is clear that the state is necessary and has some legitimate functions in society such as defending the country, enforcing contracts, keeping the market functioning, etc.
- d) Smith did not trust businesspeople and capitalists.
- e) He expected producers to pursue their self-interest in monopolizing the market.
- f) He also distrusted bankers and employers who sought to keep wages low.
- g) For Smith, rich merchants had a disproportionate influence over parliament in contrast to other groups they used to persuade the state to allow them to disregard competitive pressures and that the interests of the merchants was identical to society's interest.

- h) The exceptions merchants gained from parliament included exclusive use of licenses, tariffs, quotas and other protectionist measures.
- i) Even though Smith favored *laissez-faire*, he also favored the state enforcing competition to help the market function properly. He feared what today is known as **rent-seeking**, which occurs when the state rigs the market in ways that favor or rewards certain (powerful) businesses.
- j) For these reasons the state was also *visible* in that state power was necessary to make the market work properly in the face of capitalists who would destroy the market.
- k) In *The Theory of Moral Sentiments*, the market must be proactively structured in such a way as to produce righteous and prudent people. Sounding like Marx, Smith said “the welfare of servants, laborers, and workmen of different kinds” should be the prime concern of economic policy.
- l) Serving one’s own interests in a competitive society means competing to best serve the interests of others, to behave honestly, and to gain a reputation for fairness.

#### THE TRANSFORMATION OF LIBERAL IDEAS AND POLICIES

- a) Smith’s writings were part of a broader intellectual movement that engendered intense economic and political change in society. Other writers in this rubric included John Locke and Thomas Jefferson.
- b) Liberal political philosophy holds that in order for markets to work, people need to have negative rights (freedom from state interference and freedom from unlawful imprisonment), along with positive rights (freedom to do certain basic things such as freedom of speech), and a participatory democratic form of government to guarantee the positive and negative rights.
- c) Economic liberals focus on the domain in which nation-states show their cooperative, peaceful, constructive natures through harmonious competition.
- d) International trade is a positive-sum game that benefits all parties, and not a cutthroat zero-sum competition as mercantilists assume.
- e) Smith condemned tariffs (taxes) and most state restrictions on trade, but did support the mercantilist Navigation Acts that protected British industries
- f) David Ricardo was one of the first economists to explore the scientific principles of free trade, arguing that using talents and resources appropriately and trading for other goods and services created maximum economic benefit to the trading parties.
- g) These positive-sum payoffs bind states together by common interests in economic intercourse.
- h) Economic liberal supporters of globalization argue that strong ties of mutual advantage weaken the need for national security and war while helping generate a “universal society.”
- i) Ricardo vehemently opposed the Corn Laws (see Corn Laws box on p. 33)

#### Box: Britain’s Corn Laws

- a) The **Corn Laws** were restrictions on food imports enacted by Britain in 1815 to protect the agricultural interests that then dominated Parliament.
- b) Industrial interests and liberals, including Ricardo, opposed the Corn Laws, as they increased production costs, reduced profit, and limited the amount that other nations imported from Britain.
- c) After the Corn Laws were repealed in 1846, industrial production and exports increased, allowing for short-term expansion of the British economy and building national wealth and power.

#### JOHN STUART MILL AND THE EVOLUTION OF THE LIBERAL PERSPECTIVE

- a) Mill doubted the extent to which the competitive process and economic freedom of capitalism would turn the pursuit of self-interest into the service of society’s welfare.
- b) Selective state intervention in the market, including educating children and assisting the poor, would help correct the market’s inherent inequalities.
- c) As liberalism evolved, *laissez-faire* was still the guiding principle; however, liberals had to accept some governmental interference in the market to achieve a number of social objectives.

#### JOHN MAYNARD KEYNES AND THE GREAT DEPRESSION

- a) **Keynesianism** refers to the ideas and policy recommendations of John Maynard Keynes during the Great Depression. Like Mill, Keynes believes that there are situations where the state must play a larger but still limited role in the economy in order act to protect society from the negative effects of infallible markets.

- b) The state should try to mediate the ups and downs of the market so as to limit the uncertain effects of the market on society. In the 1930s the United States used a combination of monetary and fiscal policy to sustain wages for labor, instead of worrying about inflation. One effects was spending deficits along-side many public works projects and other measures to restore growth and faith in the economy.
- c) The 1929 Great Depression, the 1997 Asian financial crisis, and current financial crisis demonstrate investor pursuit of rational-individual self-interests who were spooked and stampeded out of the market do not always coincide with enlightened social-collective interests.
- d) The **paradox of thrift** accounts for both investors and consumers to not want to spend during a recession or depression, increasing unemployment and worsening the chances of recovery.
- e) International speculation also needs regulation because it makes financial market prone to economic disaster.
- f) Like Smith, Keynes argued that the economy should serve society and that accumulating wealth was a “somewhat disgusting morbidity.”

#### The Keynesian Compromise: Reconciling State and International Interests

- a) Keynes played a major role in the reconstruction of Western Europe after World War II.
- b) A major problem was how to reconcile the objectives of restoring stability and economic growth which required limiting protectionist policies and opening up the international economy, all the while helping states recover which required positive state action.
- c) The **Keynesian Compromise** is the idea that management of the international economy would reflect peaceful cooperation of states to work through the three Bretton Woods institutions (the IMF, World Bank, and GATT) while states agreed to *gradually* reduce state protectionist policies.
- d) The idea of **embedded liberalism** accounts for situation between the 1930s and 1970s where international markets were subject to social and political restraints and regulations that reflected chiefly domestic priorities.
- e) **Hegemonic stability theory** is the idea that international markets work best when a **hegemon** (a single dominant state like the United States after World War II) accepts the costs associated with keeping markets open for the benefit of both itself and its allies by providing the allies with certain international **public goods** such as defense and foreign aid at its own expense.

#### THE RESURGENCE OF CLASSICAL LIBERALISM

- a) As Keynesian liberalism evolved to justify a good deal of state intervention in the market, a backlash movement developed in the 1970s when some of Keynes’ ideas about the relationship of recessions to inflation became suspect.
- b) In the late 1970s and 1980s the classical economic ideas of Friedrich Hayek and Milton Friedman, became the basis of what became known as **neoliberalism**, which replaced those of Keynes as the dominant outlook about the international political economy.
- c) Hayek wrote about the importance of freedom and the slippery slope we face when we begin to empower the state to provide things individuals could better provide for themselves. Milton Friedman wrote of the dangers of concentration of power in the state and the importance of political and economic freedom (to choose).
- d) Many neoliberal ideas form the basis of the recent policies of U.S. vice-presidential candidate Paul Ryan who argues that “paternalistic government will stand in the way of the pursuit of happiness and the good life.”

#### REAGAN, THATCHER, AND THE NEOLIBERALS

- a) President Ronald Reagan in the U.S. and Prime Minister Margaret Thatcher in Great Britain were influential in the advance of neoliberal policies as well as public support for these policies.
- b) Neoliberal policies (often referred to as **Reaganomics**) often involved privatization of state-run enterprises, deregulation or a decrease of the state’s role in the market, and tax cuts. These policies were later credited with helping the U.S. and to some extent Western Europe’s economies recover from an economic recession in the late 1980s and early 1990s.
- c) Thatcher’s motto about economic liberal policies was TINA—‘There Is No Alternative.’

- d) In the 1980s the United States promoted globalization—policies that extend economic liberal ideas and policies the world over.
- e) One assumption was that expanding economic growth would also help realize democracy the world over.

#### THE 1990s AND 2000s: NEOLIBERALISM AND GLOBALIZATION UNDER ATTACK

- a) Initially, **neoliberalism** was initially credited with helping the international economy recover in the early 1990s. The Clinton administration supported many economic liberal trade agreements and a new World Trade Organization (WTO) to replace the GATT.
- b) By the turn of the century neoliberalism was under attack by anti-globalization protestors for supposedly causing violations of human rights, damaging the environment, depriving poorer countries of effective representation in international economic organizations, and fostering sweatshops in developing countries.
- c) Globalization was not creating a more peaceful world.
- d) Former employees of the World Bank and the IMF criticized these institutions for imposing neoliberal policies on nations that did not have the proper institutions to allow the market to work properly, and for making it difficult for developing nations to get out of debt.
- e) As they viewed the disparities between the rich and poor, most experts began to acknowledge that relying solely on neoliberal economic policies would likely undermine the prosperity of even the richest nations. Instead, markets needed to be **embedded** in social and political institutions in order to have legitimacy and to resolve fundamental human problems.
- f) An ardent supporter of globalization Thomas Friedman, acknowledged many of the problems globalization contributed to.
- g) Despite these critics and problems with globalization, many experts such as Jaghdish Bhagwati and Paul Collier continue to defend many neoliberal ideas.
- h) By the mid-2000s a number of critics and supporters of globalization had converged around the argument that some better regulations and global governance are needed to deal with a variety of issues that cannot be solved by unfettered markets and globalization alone.

#### The Financial Crisis: A Stake in the Heart or Just a Scratch?

- a) No single event in recent history has seemingly undermined economic liberalism as much as has the recent financial crisis, which produced the most severe economic collapse since the Great Depression.
- b) U.S. Fed Chairman Greenspan admitted that his faith in self-regulating financial markets had been misplaced and that there were flaws in economic models of how the world works that led to excessive speculation and investor risk taking in large parts of the world.
- c) Presidents Bush and Obama and later many European officials felt that there was no alternative but for the bank to bail out the many banks that had failed. (Chapters 8 and 12 contain more details about the current crisis.)
- d) In the absence of state regulation, many banks and investment firms took on excessive economic risk. However, most of the risk was assumed by new investors, allowing original investors to profit handsomely.

#### An Outdated Economic Theory and Ideology

- a) Many experts criticized state regulation, arguing that markets were self-correcting mechanisms. Some argue that free market theorists have underestimated distortions in markets, overestimated markets' ability to self-adjust, and failed to account for the long-term problems resulting from markets' short-term incentives that led to excessive speculation.
- b) The financial crisis reinforced the idea that economics was still a “dismal science” that had become obsessed with mathematical models and an emphasis on fighting inflation, while allowing for recurring asset bubbles.
- c) Professor Robert Schiller argued that “group think” played a major role in shaping the views of both experts and officials.
- d) The promises of wealth and faster growth took priority over social stability and relative income distribution.
- e) Laissez-faire policies were heavily promoted by the wealthy and the “financial oligarchy” in Washington, D.C. and many European capitals.
- f) Christina Freeland labels the group a “plutocracy” that moves freely about the world benefitting from tax breaks and government subsidies.

- g) Matt Taibbi and Charles Ferguson argue that together with high paid lobbyists, they operate at the expense of the public.

#### We Are All Keynesians Now (Again! At Least for a While?)

- a) The financial crisis brought about the re-emergence of Keynesian thought among **heterodox interventionist liberals (HILs)**, who believe the economy should serve the broader interests of society rather than just the wealthy.
- b) In contrast to **orthodox economic liberals (OELs)**, most HILs believe the financial system requires a sophisticated and effective regulatory and legal framework that only the state can provide—a state strong enough to enforce those laws but without stifling the profit motive, economic freedom, and individual liberty.
- c) While HILs are not opposed to globalization per se, many such as Joseph Stiglitz, Simon Johnson, and Martin Wolf of the *Financial Times* believe that it should be managed in such a way that allows for greater wealth distribution to the masses, for instance, by state provided regulatory and legal frameworks to enforce laws without stifling profit, freedom and liberty.
- d) Developing countries, for example, should be allowed more protection while industrialized nations reduce their barriers to trade.
- e) Economic-oriented international finance institutions such as the IMF, World Bank, and WTO should get away from a “one-size-fits-all mentality of how economies should be run.
- f) Many HILs are open to creating different kinds of economies and social systems. (See the Ordoliberalism box below.)
- g) *Laissez-faire* ideas remain popular for several reasons: they are deeply entrenched in values and ideals of many societies; they are relatively easy to understand; they invoke the promise of greater wealth; they are supported by the wealthy; and they continue to be promoted by politically powerful individuals.

#### Box: *Ordoliberalism and the Social Market Economy*

- a) **Ordoliberals** believe that the failings of liberalism resulted from the failure of nineteenth and twentieth century “laissez faire” policy makers to appreciate Adam Smith’s insight that the market is embedded in legal and political systems. They strongly believe that the protection of human dignity and personal freedom is important.
- b) Alfred Müller-Armack, who is credited with developing the basis of the social market economy that characterizes many European states, accepted key ordoliberal principles but argued that supplemental “social” policies were necessary to ensure that market outcomes would indeed be consistent with the good society.

#### CONCLUSION

- a) Liberalism has changed to reflect a variety of different theories and changes to society in different historical periods.
- b) In the recent past OEL ideas have become very popular, especially as they have served as the theoretical foundation of “free market” policies that emphasize wealth and free enterprise but also globalization and the spread of relatively unregulated capitalism the world over.
- c) The negative effects of globalization and the recent financial crisis have called into question many of the precepts of these ideas and the policies that are associated with them.

#### Key Terms:

- economic liberalism
- heterodox interventionist liberals (HILs)
- orthodox Economic Liberals (OELs)
- rent-seeking
- Corn Laws
- positive-sum game
- zero-sum game
- Keynesianism

- paradox of thrift
- Keynesian compromise
- embedded liberalism
- hegemonic stability theory
- hegemon
- public goods
- neoliberalism
- Reaganomics

#### Teaching Tips:

- This chapter contains many quotations that can be used effectively in class to bring out the power and complexity of liberal ideas. Smith and Keynes provide especially good material for understanding the complexity of these thinker's views and student reaction to them.
- One of the themes of this chapter is the evolution of liberal ideas and values as part of liberal theory and policy (liberalism) and its consequences for state–market relations and different policies. Some students will be confused by the fact that liberalism and conservatism are nearly synonymous, in the sense that these terms are sometimes used in IPE. It is a good idea to simply confront this problem right at the start to avoid confusion later. Try to draw out this dynamic element as you go through this chapter. Ask students to carefully distinguish between classical liberalism and economic liberalism as we understand it today. Ask them why they think there is now so much tension between political liberals and economic liberals—or OELs and HILs.
- It is good to ask the question “What makes Mill and Keynes liberals?” This is a controversial question with respect to Keynes, but the quotations provided (and especially the suggested reading by Skidelsky) make the answer clear.
- Try to work through this material on several levels. Try to push students to see the differences in shading and color that distinguish, for example, a Keynesian economic liberal and an OEL. Also press your students to understand why economic liberals do not accept mercantilist arguments. On the other hand, for many reasons (discussed in different chapters of the book), this distinction has been breaking down. And as noted in the chapter, the lines between political and economic liberalism have been blurring. Encourage students to look for this mixing and the tensions that it causes when it comes to explanations of the financial crisis in other chapters of the text.

#### Sample Essay-Discussion Questions:

1. Adam Smith and John Maynard Keynes are both liberals, in the broader sense this term is used in IPE. Explain what views Smith and Keynes share regarding the market, the state, human nature, and power. How do they differ?
2. How do liberals such as David Ricardo view international trade? Why do they hold this opinion? Explain how the Corn Laws debate in nineteenth-century Britain illustrates the conflict between mercantilist and economic liberal views of international trade.
3. John Stuart Mill and John Maynard Keynes thought that government could and should play a positive role in correcting problems in the market. Discuss the specific types of “market failures” that Mill and Keynes perceived and the types of government actions they advocated. What kinds of policy recommendations do you think Mill and Keynes would favor today? Explain.
4. The term “liberal” in IPE means something different from what it means in everyday political discussions. Explain the difference and briefly explain how and why the term took on its current meaning. Use some of the works or points in the chapter related to Margaret Thatcher, Ronald Reagan, Milton Friedman, Dani Rodrik, Paul Collier, Thomas Friedman, James Galbraith, Martin Wolf, Alan Greenspan, or ordoliberalism in the EU to discuss what it means to be a liberal today. Another case would be that of presidents Bill Clinton, George W.

Bush, and Barack Obama, who some argue are very similar to one another when it comes to their views about the role of the state in the economy. Or are they?

5. Apply the issue to the state's role in the economy and market failure today. Depending on your own background and interests, discuss with students where this tension exists today in different countries or in relation to different issues such as the causes of the current global financial crisis.
6. Another issue is the popularity of economic liberal values and policies, especially in the United States. Ask students to explain this trend and why neoliberalism appears to be in decline at the moment. Also ask them why during the global financial crisis many experts have recommended reading Keynes over economic liberals such as Hayek or Milton Friedman.
7. Discuss the liberal view of hegemony stability theory and contrast it with the views of mercantilists and structuralists (when Chapter 4 is read). Ask students how the theory would apply to the issue of the causes of the current global crisis and solutions to solve it. (Note: Chapter 8 would be very helpful here, but for now get the conversation going.)

#### Sample Examination Questions:

1. Adam Smith favored "laissez-faire" policies, where individuals would achieve social benefit guided by the "invisible hand." The invisible hand stands for
  - a) government regulation.
  - b) individual self interests and choices.\*
  - c) hegemonic stability.
  - d) hidden income taxes.
2. When it came to moral sentiments, which of the following best states Smith's ideas?
  - a) No society can flourish and be happy if the far greater number of its members is poor and miserable.\*
  - b) Parliament should always represent the interests of the working class.
  - c) Bankers and special interests should have more influence in the legislature given the economic benefit derived from their investment in industrial output.
  - d) Serving one's own interests in a competitive society means competing to best serve the interests of industrial society.
3. David Ricardo favored free open international markets. Which of the following ideas about free, open markets is not associated with Ricardo?
  - a) open market promotes efficiency
  - b) free trade binds nations together and promotes the universal good
  - c) open markets results in zero-sum benefits to all\*
  - d) open markets lead to greater wealth
4. John Stuart Mill is most noted for changing liberalism to reflect
  - a) the need for less state regulation of the economy.
  - b) that states should do more to stimulate industrial output and free trade.
  - c) advocating selective state action in cases where individual initiative might be inadequate in promoting social welfare.\*
  - d) that strong powers have legitimate interests in promoting social progress in their colonies.
5. Which of the following is NOT one of the five main tenets of capitalism listed by the authors?
  - a) the existence of markets for land, labor, commodities, and money
  - b) freedom of enterprise
  - c) democratic institutions\*
  - d) markets coordinate society's activities

6. The Keynesian compromise can be summed up in which of the following statements?
  - a) The tradeoff between the need for domestic regulation while gradually opening up international markets.\*
  - b) Keynes' agreement with White to work on the World Bank at Bretton Woods instead of the IMF.
  - c) Consumers making rational (individual) choices that result in unexpected damaging outcomes that hurt the community.
  - d) The necessity for state intervention in the economy because markets fail.
  
7. In the liberal point of view, a hegemon is
  - a) a rich and powerful state that supplies the international public goods necessary for a peaceful and prosperous IPE.\*
  - b) a strong nation that uses its wealth and power to set the rules of the IPE, so as to gain more wealth and power for itself.
  - c) a free rider.
  - d) a strong capitalist nation that uses its power to exploit less developed countries.
  
8. Which of the following statement about the views of President Reagan and Prime Minister Thatcher are *incorrect*?
  - a) They both favored market deregulation.
  - b) They both owe a lot to the ideas of Adam Smith, David Ricardo, and Milton Friedman.
  - c) They both recommended selling off (privatizing) public industries to allow for more competition and competitive pricing.
  - d) They both agreed that the United States should have an empire like Great Britain did in the nineteenth century.\*
  
9. The term "embedded liberalism" refers to
  - a) the idea that markets are not natural and must be carefully planned for by the state officials.
  - b) the idea that markets need to be encapsulated in political and social institutions in order for them to be viewed as legitimate.\*
  - c) the idea that foreign aid should be used in some cases where markets have failed to help the poor.
  - d) the idea that markets need to be an accepted institutions for international organizations and nongovernmental organizations.
  
10. This supporter of globalization has recently been critical of its impact on the environment and supports increase state regulation in this policy field to promote, among other things, energy efficiency?
  - a) Joseph Stiglitz
  - b) Paul Collier
  - c) William Easterly
  - d) Thomas Friedman\*
  
11. According to the authors, the financial crisis has led many HILs to assert that \_\_\_\_\_ must act to save the financial system and even capitalism itself.
  - a) the U.S. Congress
  - b) big banks
  - c) the state\*
  - d) taxpayers
  
12. According to HILs, when it comes to reforming the WTO, IMF, and World Bank, they would like to see
  - a) more state contributions to these IOs.
  - b) getting away from the "One-Size-Fits-All" mentality.\*
  - c) the United States adopt measures to coerce them into reforming.
  - d) much less power for these three IOs.

13. Which of the following is NOT likely to be on the list of things OELs would recommend to solve the global financial crisis?
- a) limit government support for banks, infrastructure projects, and social welfare programs
  - b) decrease regulation of many parts of the economy
  - c) cut taxes of the wealthy and middle class to stimulate economic growth
  - d) do more to insulate people from the negative effects of globalization\*
14. According to Ordoliberals \_\_\_\_\_ is the basis of their plan that makes it work.
- a) high economic growth rates
  - b) open and unfettered markets
  - c) constitutional rules immune from political manipulation\*
  - d) a strong regulatory state
15. Who admitted before a U.S. congressional committee that he had made a big mistake when it came to the fundamental assumptions of market failure and models?
- a) Ben Bernanke
  - b) Henry Paulson
  - c) George W. Bush
  - d) Alan Greenspan\*