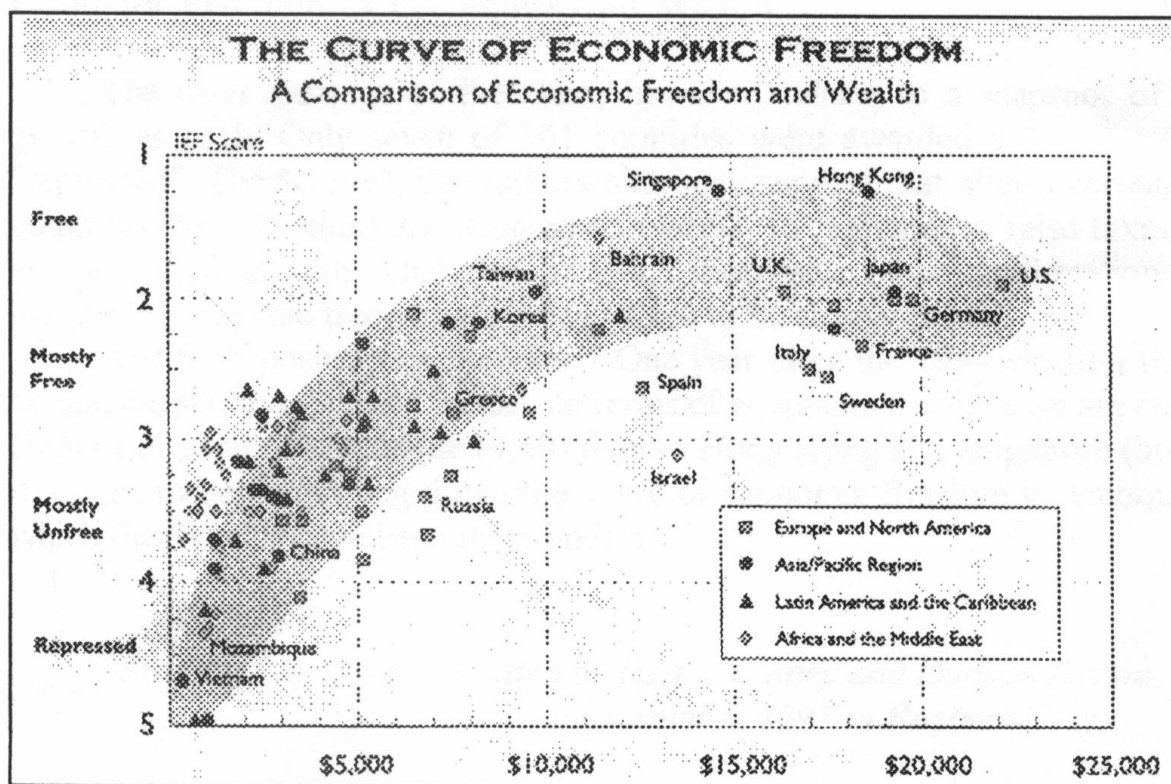


## Development and Economic Freedom

As far as socialism is concerned, the fat lady has been singing for a while now. Apart from a few Stalinist holdouts like Cuba and North Korea, it is dying and nearly gone. But most countries still do not have free economies. This gives added force to Marinus Daling's call in a recent speech (late 1995) for economic freedom fighters. He need look no further than to the compilers of the accompanying diagram.



It is taken from a recent study from Heritage Foundation in Washington DC. Written by Bryan Johnson and Thomas Sheehy, the *Index of Economic Freedom* (1995) is a 250-page manual – the first of its kind – which carefully and comprehensively constructs a composite indicator of economic freedom for more than 100 countries. Aimed at two audiences, the index provides information at once disturbing and encouraging. One set of readers is the group of policy makers responsible for targeting and providing foreign aid. Will aid be squandered in economically unfree countries? The paradox is that countries apparently most in need of (US) aid are the least deserving, since their government-controlled economies will misuse it. The countries less likely to squander (US) aid, precisely because they have free economies, are also those which least need it. The key to development, Johnson and Sheehy conclude, is not aid but economic freedom. This is where a second set of readers will find the report invaluable. Foreign investors will have a better idea which countries will give them a decent return.

### Why business invests abroad

Foreign investment decisions naturally require detailed analyses by firms themselves, but the report provides an assessment of the economic "fundamentals". These can mean more to investors than whether or not a government claims to be targeting a given business "cluster" or industrial sector for growth. Targeting, after all, is not an indicator of economic freedom but rather of manipulation. The fundamentals which are included in the index on an objective and quantitative basis include tax rates,

currency stability, trade policy, private property rights, the size of the government sector, the level of regulation, the presence of a black market, capital flow controls and wage and price controls. Development economists will no doubt debate and analyse these factors, whether they were appropriately measured, and whether the weightings given to each are valid. However, such critiques should not be delayed. The Heritage Foundation intends repeating its exercise on a regular basis.

And, of course, repeated reruns may or may not confirm the current impressionistic view that over time countries which pursue economic liberalisation grow more rapidly. Hong Kong, Singapore, Taiwan and South Korea are cited as rapid-growth (1965-1991) countries with high (1995) index values. African economies have much lower values, but to the extent that some African countries had relatively less poor indicators of economic freedom they did indeed grow more rapidly over that period.

### **Economic freedom: A prerequisite for wealth**

The main message of the chart, however, relates to a snapshot of the level of development, not growth as such. Only seven of 101 countries were awarded a "free" score. Eight were deemed to be "repressed". The "curve", the authors hint, may suggest that after a certain level of prosperity is achieved countries (like Sweden) are tempted to regress, to regulate, to raise taxes, increase welfare programmes and so forfeit growth. That sort of speculation must await confirmation. Nevertheless, economic wellbeing and economic freedom do indeed seem to be closely linked.

And SA's position on the chart? One year after the 1994 election the Heritage writers computed a composite score of "three" for SA. In terms of economic freedom we are closer to such repressed places as Haiti (4,20) and Mozambique (4,40) than to Hong Kong and Singapore (both 1,25). We are not yet ready, it seems, to begin moving down the curve of economic freedom by embracing redistributive welfarism of which the Swedes have been the pioneers.

*This Briefing Paper was written by Henry Kenney and Duncan Reekie and previously appeared in November 1995 in Business Day.*