

The power of freedom

Once upon a time everyone, or at least all up-to-date thinkers, “knew” that governments had to play a major role in encouraging economic progress. This was especially true of poor countries where markets were supposedly too weak to do the job of improving the living standards of the mass of the population.

This kind of thinking had a lot to do with what was going on in the Soviet Union. Here, we were told, was the classic model of an economically backward country dragging itself up by its bootstraps, under the auspices of a far-seeing state which steered the economy along the correct path. Socialism was “the only way” in these conditions, and if it meant that some economic and political freedoms temporarily had to be sacrificed, then, said the tough-minded, it was just too bad. There was no alternative. Posterity would reap the rewards of the sacrifices made by the current generation.

Under the influence of the “Soviet Model”, interventionist approaches were long dominant in the poor countries of Africa, Asia and Latin America after World War II. Economic progress had to come through state ownership of the “commanding heights” of the economy. Inevitably, infant industries needed a period of tariff protection against cheaper foreign imports before they eventually reached the stage where they could stand on their own two feet.

By now we know that all this was wishful thinking. The infants never did grow up, and the Third World became riddled with high-cost uncompetitive industries which could only survive with further benevolence from the state. The largest economic sector, agriculture, stagnated, as it had to subsidise the parasitic sectors of the economy. Unemployment became a major problem. The rewards of what economic growth there was went to politicians, bureaucrats (or kleptocrats, as they were known in Poland), and workers fortunate enough to be employed in the protected industries.

So socialism had fallen on evil times long before the collapse of the Soviet Union put the final seal on its demise. But the interventionist mindset dies hard. When Nelson Mandela was released from prison, even he could hardly wait to proclaim the Freedom Charter’s demand for the nationalisation of the mines, the banks and “monopoly industry”.

Fortunately, that was just the aberration of a man who had spent too many years in prison. Since then the ANC has moved to other insights. It accepts the need for privatisation; there is now much talk of free markets. But within the ANC alliance there are still plenty of enthusiasts for the economics of the past. As long as Cosatu continues to have the clout it does, there will be reservations about the government going more rapidly down the road of a genuine market economy.

The economic facts

If we have any doubts about the urgency, we need only look at a study which appeared last year: *Economic Freedom of the World: 1975-1995* by James Gwartney, Robert Lawson and Walter Block. Co-published by 11 economic institutes around the world, the study is the outcome of a series of six conferences sponsored by the Fraser Institute of Vancouver and the Liberty Fund of Indianapolis between 1986 and 1993. The 62 conference participants included some of the world’s top economists, including three winners of the Nobel Prize.

On the basis of its examination of 103 countries over a 20-year period, the study compiled an index which measured ways in which governments restrict economic freedom. The index has 17 components, which shows that economic freedom is a complex thing. It cannot simply be reflected by the amount of public spending relative to GDP, or by the degree of state ownership of industry. These do enter into the index, but it also includes price controls, industrial regulation, exchange controls, the level and impact of marginal tax rates, the level and variability of inflation, subsidies and transfers between citizens as a share of GDP, and the presence of conscription.

It boils down to some broad questions. Does government protect the money in your pocket from eroding in value through inflation? To what degree does government decide what should be

produced and consumed? To what extent does government take from you to give to others? How free are you to enter into dealings with foreigners?

The authors of the study rated the 103 countries on each of the components on a scale of 0-10. Zero meant complete unfreedom with respect to the measure involved, and 10 amounted to total freedom. Once the ratings had been obtained, the authors had to decide what weight to apply to each. For instance, did strict exchange controls matter more for economic freedom than high marginal tax rates? As it was unlikely that they all mattered equally, the authors decided to rely on a survey of the views of the 62 economists who attended the six conferences between 1986 and 1993.

The findings of the study were emphatic. They showed that countries with the most economic freedom grew most rapidly over the 20-year period, ie at an average of 3,3 % per annum per capita GDP. So rapid growth was reflected in higher income levels. By the same token, countries with the lowest level of economic freedom achieved in 1994 the lowest level of GDP, viz \$1 650 per capita in 1985 dollars.

As the authors put it: "There were no exceptions - every nation that significantly improved its rating also achieved solid economic growth. On the other hand, economies that moved away from economic freedom were characterised by sluggish growth and decline".

The findings also revealed that the six countries with persistently high (economic) freedom ratings throughout the 1975-95 period (Hong Kong, Switzerland, Singapore, the US, Canada and Germany) were also in the top 10 in terms of GDP per head in 1993-5. The implication is that high levels of economic freedom should be maintained for a while, so that expectations about their lasting nature should establish themselves. "Thus," the report stated, "countries that move steadily and consistently toward economic liberalisation are likely to achieve a higher level of economic performance than those that shift back and forth between liberal and restrictive policies".

It follows that countries with persistently low ratings could have been expected to register declining real incomes. And so they did, ie places such as Nicaragua, Iran and Somalia.

The burning question is of course how SA shaped. Unfortunately, not too well. The study placed this country just about in the middle, 54th (with Greece and Cyprus). In terms of economic freedom we were closer to Bangladesh and Pakistan than to Argentina and Chile. It could have been worse. We have not been as inadequate as Zimbabwe (85th), but we are somewhat behind Botswana (46th), the most free in Africa, with per capita GDP increasing at an annual rate of 6,4 % in the 1980s and by 4,6 % since 1985.

There has been a lot of continuity in the SA story. Our rating "has been relatively steady - there is no evidence of a consistent commitment to or movement toward economic freedom". In short, neither the Nationalists nor the ANC-led government of national unity have shown any practical enthusiasm for a genuine market economy.

One obvious consideration is uncertainty about future political stability as it "reduces the security of property rights and the incentive of both foreigners and domestics to invest". In general, the study stated that "policies that restrict economic freedom and undermine the workings of a market economy ... abound in SA".

Excessive monetary growth over two decades has made double-digit inflation common. Government consumption expenditures account for more than 20 % of GDP (compared with less than 10% in both Hong Kong and Singapore), and public enterprises are common. The study's prognostication is bleak: "These factors, along with the high taxes for their support, distort and weaken the operation of markets. In recent years, budget deficits have averaged around 6% of GDP. Deficits in this range are unsustainable. If they are not brought under control, they will eventually lead to printing press finance of government and hyperinflation".

Liberty and choice

So the evidence shows that there is a close connection between economic freedom, economic growth and rising living standards. But why should economic freedom be so important? Essentially,

because it is about property rights and choice. Intrusions on property rights by governments inevitably harm incentives. High marginal tax rates, subsidies, industrial policy, lavish welfare handouts, all these blunt the incentives of those who would otherwise seek out profitable trading opportunities.

When property owners are not protected against the power of the state to grant privileges to special interest groups (whether trade unionists, industrialists seeking special favours, empire-building bureaucrats, or receivers of welfare) then trade will be restrained and costs will rise. Uncertainty will reduce the incentive of individuals to engage in productive activities.

In SA we are familiar with these disincentives. Despite all the fine words, we are reluctant to privatise, our tax rates are notoriously high, the demands for increased welfare are monotonous, and both exchange control and unacceptably high inflation seem to be permanent features of the SA way of life.

We are still playing the redistribution game, in which success goes to those who manage to gain the largest slices of a given economic pie. Economists call this rent-seeking, which is about the pursuit of bigger helpings of what has already been produced. Profit-seeking is a different creature entirely. It is about making money by producing more goods and services for consumers, the ultimate arbiter. But this will only happen if the incentives are right, if property rights are protected and government's presence in the economy is less than intrusive. In short, if economic freedom exists.

What about the poor?

The famous West Indian economist and Nobel Prize-winner, Arthur Lewis, once explained why economic growth is so important for the poor: It "creates a shortage of skilled workers and incites employers to upgrade persons and jobs ... the disadvantaged and the subordinate have vested interest in fast economic growth. Every reduction in the target rate for economic growth is also a reduction in the strength of equalising forces". And the record shows that sustained economic progress requires economic freedom.

This is the main reason why black empowerment in SA can only succeed if we make a genuine commitment to free markets, instead of only sounding off about it. If we don't, we will find ourselves among those countries which the study describes as "persistently unfree", in the company of the likes of Algeria, Syria and Tanzania. Not only will we remain poor, but we will become still poorer. This will be bad news for all of us, but it will be even worse news for the cause of black empowerment.

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