

## Freedom Works

The double difficulty of prosperity lies in the fact that it is hard both to achieve and to retain. Often, trying to retain it results in losing it altogether and acquiring riches can be a bloody mission as the - now discredited<sup>1</sup> - economic growth of Soviet Russia under Joseph Stalin can attest. In analysing whence comes prosperity, this essay shall look at both theory and practice, trying to ascertain the important features of growth in culturally diverse societies as well as contrasting them with an example of failure.

To best utilize the sum of knowledge in a society, it has often been thought appropriate that a wise man or woman should direct it. In actual fact, however, societies in which activity is undirected by authorities have historically outperformed all alternatives. As was noted by F. A. von Hayek, the great advantage of the free market is that it gives rise to a “spontaneous order”<sup>2</sup> in which the price mechanism automatically signals shortages and abundances when people - unaware of what others do - try to acquire goods according to their best interests. If the supply exceeds demand, the price will fall, while the converse causes prices to rise. If high, the new price is an incentive to produce more and vice versa. By quickly providing essential information for both producers and consumers, the price mechanism of the free market ensures both parties attain a surplus maximum.

The price mechanism is a law of economics that cannot be changed no matter how society is organized, but its workings can be severely impeded by all forms of restricted entry into markets, fixed prices and subsidies. The rule of law must not be compromised, lest people be too wary of trading with one another due to the high transaction costs of making sure the other party sticks to the deal. In addition, it is imperative that property rights be well defined so that owners can collateralize their assets for favourable interest rates and use them to make long-term plans, knowing that their property cannot be taken away from them, as has been argued by Hernando de Soto<sup>3</sup>. Countries where these principles are followed have not only become prosperous, but also tend to be tolerant places to live in, whereas countries that have gone the other way have become destitute and often fanatical and blinkered<sup>4</sup>.

Real-world examples of the importance of a free market abound. The Republic of Ireland, for instance, experienced sluggish growth for decades after its independence. Many still think of Ireland as a comparatively poor country, but since 1995, its annual rate of gross domestic product growth has averaged almost seven per cent, meaning its G.D.P. doubles around every ten years<sup>5</sup>. Today, the average Irishman or woman is ten per

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<sup>1</sup> William Easterly, *Freedom versus Collectivism in Foreign Aid in Economic Freedom of the World: 2006 Annual Report, 2006*: <http://www.freetheworld.com/2006/2EFW2006ch2.pdf>, p. 32.

<sup>2</sup> Friedrich August von Hayek, *The Constitution of Liberty*, London (1990), p. 160.

<sup>3</sup> Hernando de Soto, *The Mystery of Capital*, London (2000).

<sup>4</sup> Niclas Berggren, *The Benefits of Economic Freedom: A Survey*, in *The Independent Review*, Volume 8, Number 2, Fall 2003: [http://www.independent.org/pdf/tir/tir\\_08\\_2\\_berggren.pdf](http://www.independent.org/pdf/tir/tir_08_2_berggren.pdf), p. 200 and pp. 203-204.

<sup>5</sup> Ireland. The 14<sup>th</sup> November 2006, in the C.I.A. World Factbook: <https://www.cia.gov/cia/publications/factbook/geos/ei.html#Econ>.

cent richer than the people of the four big E.U. countries of France, Germany, Italy and the U.K. Notable pro-market reforms include reductions in government spending and in the corporate tax rate, the latter coming down to 12.5 per cent<sup>6</sup> which makes Ireland attractive to foreign investors. Inflation was also fought successfully, although that is no longer a domestic responsibility after ceding monetary policy to the European Central Bank when joining the euro.

Some have attributed Ireland's progress to subsidies from the E.U., but if that were true, Portugal and Greece should be much richer today and Ireland should not have taken so long to start growing after joining the E.U. in 1973, when its subsidies-to-G.D.P. ratio was highest at 1:25<sup>7</sup>. In fact, it is more likely that subventions impeded growth, as it made some entrepreneurs focus on lobbying rather than innovating, while support related to the E.U.'s Common Agricultural Policy (C.A.P.) likely created an incentive for farmers not to move to the cities, but to remain in an activity which they may otherwise have found uneconomical<sup>8</sup>.

Another example of the greatness of the market is Hong Kong, a area island notable for its paucity of natural resources. The Scotsman John Cowperthwaite was installed as financial secretary by The United Kingdom in 1961 and introduced the free-market policies for which the former Crown Colony became famous<sup>9</sup>. Milton Friedman compared the economic performance of Hong Kong for the period 1960 to 1996 with that of the U.K., a welfare state for the whole period which went through fits of nationalizations in the near half-century that was analysed<sup>10</sup>. He found that in 1960, Hong Kong's G.D.P. per capita was only 28 per cent that of the U.K., but by 1996, it had risen to 137 per cent<sup>11</sup>. Cowperthwaite had faith in the market to alleviate the colony from poverty and refused to introduce almost any tariffs. Taxes were also kept low; the highest marginal tax-rate on personal income was 25 per cent in 1996 and a clause in Hong Kong's tax law stated that the highest average tax rate can be no higher than 15 per cent<sup>12</sup>.

By contrast, Zimbabwe, the darling of outside observers after its independence in 1980, has fallen from grace under a quarter-century of despotism. Agriculture, once the main export sector has been dealt a blow by imprudent and violent confiscations of arable

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<sup>6</sup> The Economist, *Ireland, Factsheet*, the 22<sup>nd</sup> June 2006:  
<http://www.economist.com/countries/Ireland/profile.cfm?folder=Profile-FactSheet>.

<sup>7</sup> Benjamin Powell, *Markets Created a Pot of Gold in Ireland*, the 21<sup>st</sup> April 2003:  
<http://www.cato.org/dailys/04-21-03.html>.

<sup>8</sup> *Ibid.*

<sup>9</sup> John James Cowperthwaite. Wikipedia, the Free Encyclopedia:  
[http://en.wikipedia.org/wiki/John\\_Cowperthwaite](http://en.wikipedia.org/wiki/John_Cowperthwaite).

<sup>10</sup> Leslie Hannah, *A Failed Experiment: The State Ownership of Industry* in Roderick Floud and Paul A. Johnson, eds., *The Cambridge Economic History of Modern Britain, Volume III*, Cambridge, the U.K. (2004).

<sup>11</sup> Milton Friedman, *The Hong Kong Experiment* in Hoover Digest-1998 No. 3:  
<http://www.hooverdigest.org/983/friedman.html>.

<sup>12</sup> Milton Friedman, *Hong Kong vs. Buchanan*, 7<sup>th</sup> March 1996, excerpt published in the Wall Street Journal's online edition: <http://www.opinionjournal.com/extra/?id=110009267>.

land from white farmers to blacks, the worst stage of which began around 2000. Correcting colonial injustices of the past by new ones appears not to be a good idea, for it is doubtful that those to whom the land was given knew how to use it so well as the former owners did. Indeed, almost one in two Zimbabweans today suffer from malnutrition<sup>13</sup>. What is more, when it had become conspicuous that property rights are no longer secure, investors shied away<sup>14</sup>, causing the Zimbabwean economy to roughly halve between 2000 and 2005<sup>15</sup>. The government has foolishly resorted to printing money in an attempt to fill its coffers, presently causing hyperinflation which corrupts the information which prices convey<sup>16</sup>.

Zimbabwe is often juxtaposed with its neighbour Botswana. Botswana is a poor country afflicted with AIDS and extreme unemployment, but it is also a democracy and has to a high extent embraced the free market. Its apparent poverty also masks the extraordinary economic gains it has made since independence, sustaining growth at a world-beating rate<sup>17</sup>. After independence, the new government promised free speech as well as a sound fiscal environment of liberalized trade and low taxes on both individuals and corporations<sup>18</sup>. Thus, by providing freedom of both expression and enterprise, Botswana knowledge is used optimally.

The cases of Ireland, Botswana, Hong Kong and Zimbabwe illustrate that when wealth is unbound by the whims of commissars, it tends to gravitate towards ideas that are likely to yield high payoffs. The rise of mobile phones, the origins of aviation and the automobile neatly illustrate the inherent serendipity of the free market and the same thing also happens between countries. Ireland is a small country in the European Union but its free-market policies have nevertheless attracted one fourth of all new U.S. investment in the E.U. since the mid-90's<sup>19</sup>. In Hong Kong, entrepreneurs were largely unfettered as government spending as a share of G.D.P. never exceeded 15 per cent while under the U.K.<sup>20</sup>. By contrast, Zimbabwe is unattractive to investors because property rights are insecure, the government is ubiquitous and hyperinflation is in full sway.

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<sup>13</sup> Land Reform in Zimbabwe. Wikipedia, the Free Encyclopedia:  
[http://en.wikipedia.org/wiki/Land\\_reform\\_in\\_Zimbabwe](http://en.wikipedia.org/wiki/Land_reform_in_Zimbabwe).

<sup>14</sup> Craig J. Richardson, *How the Loss of Property Rights Caused Zimbabwe's Collapse* in *Cato Institute Economic Bulletin no. 4*, the 14<sup>th</sup> November 2005: <http://www.cato.org/pubs/edb/edb4.pdf>, p.2.

<sup>15</sup> Calculated using O.E.C.D. statistics from Zimbabwe,  
<http://www.oecd.org/dataoecd/45/43/32411615.pdf>, p. 357 for the years 2000-2004 and CIA World Factbook statistics from Zimbabwe. The 14<sup>th</sup> November 2006, in the C.I.A. World Factbook:  
<https://www.cia.gov/cia/publications/factbook/geos/zi.html#Econ> for 2005 (estimate).

<sup>16</sup> Zimbabwe's inflation steams ahead, BBC, the 9<sup>th</sup> June  
2006:<http://news.bbc.co.uk/1/hi/business/5065368.stm>.

<sup>17</sup> Botswana. The 14<sup>th</sup> November 2006, in the C.I.A. World Fact book:  
<https://www.cia.gov/cia/publications/factbook/geos/bc.html#Econ>.

<sup>18</sup> Scott A. Beaulier, *Explaining Botswana's Success: The Critical Role of Post-Colonial Policy*:  
<http://www.cato.org/pubs/journal/cj23n2/cj23n2-6.pdf>.

<sup>19</sup> The Heritage Foundation, *2006 Index of Economic Freedom*, Ireland:  
<http://www.heritage.org/research/features/index/country.cfm?id=Ireland>.

<sup>20</sup> Friedman, *The Hong Kong Experiment*.

Attracting foreign investment requires fewer impediments to trade. The theoretical case for free trade has been sound for over 200 years since the days of David Ricardo and Adam Smith. Free trade expands markets and the resultant increase in competition between firms typically brings about specialization and cheaper goods for consumers. Farming used to be the biggest employer everywhere a few centuries ago, but increased trade largely made it possible for farmers of fruitful soil to supply ever-larger regions with food. In more arid places, farmers were freed up to do other things, as their services were fulfilled more effectively by others.

Indeed, when people all over the world are doing that which they are least bad at, output is optimized<sup>21</sup>. An obvious example is that it would not be profitable to grow pineapple in Norway, so it is better if Norwegians import their pineapple from Hawaii and instead focus on fishing or producing oil. Thus, theory can corroborate the beneficial effect of free trade in Hong Kong and Ireland above. Moreover, when there is a world market rather than an autarky in which to sell one's product, innovations are more greatly rewarded due to the higher number of potential purchasers.

The conclusion that free trade is good for growth has also been arrived at by the Copenhagen Consensus, a project concerned with establishing priorities for augmenting global welfare. It has found that between 1950 and 1998, countries which raised their trade-to-GDP by an average of five percentage points enjoyed a mean of 1.5 per cent higher annual growth compared to their pre-reform rate<sup>22</sup>. In 2004, the Copenhagen Consensus estimated the gains from a worldwide removal of all barriers to trade and all agricultural subsidies to amount to between \$254 and \$2,080 billion annually, if started in 2005<sup>23</sup>. That number can be compared to Warren Buffett's generous decision in the summer of 2006 to donate most of his \$46 billion fortune to charity<sup>24</sup>.

The fact that most people in the U.S.A. have considerably less money than Warren Buffett is sometimes mistaken as evidence that economic freedom is not egalitarian. It is true that economic freedom and income inequality are negatively correlated<sup>25</sup>, but it should not be observed in such a static way because indigents are not necessarily going to remain poor forever. Neoclassical economics teaches us that people's present consumption is not constrained by their present income, not because of spectacular innumeracy, but because individuals generally have a good idea about what their pecuniary situation of tomorrow will be like. This is why spending by America's poorest fifth exceeded their income by 95 per cent in 2004<sup>26</sup>. Most people in the poorest fifth do not suffer from poverty, but rather from a much less serious income instability.

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<sup>21</sup> Dwight R. Lee, *Specialization and Wealth in The Freeman*, (August 1998):<http://www.fee.org/publications/the-freeman/article.asp?aid=3509>.

<sup>22</sup> Kym Anderson, *The Challenge Paper on Subsidies and Trade Barriers* (summary):  
<http://www.copenhagenconsensus.com/Default.aspx?ID=227>.

<sup>23</sup> *Ibid.*

<sup>24</sup> Warren Buffett. Wikipedia, the Free Encyclopedia: [http://en.wikipedia.org/wiki/Warren\\_Buffett](http://en.wikipedia.org/wiki/Warren_Buffett).

<sup>25</sup> Berggren, p. 201

<sup>26</sup> Nicholas Eberstadt, Why Poverty Doesn't Rate, The Washington Post, the 3<sup>rd</sup> September 2006:  
<http://www.washingtonpost.com/wp-dyn/content/article/2006/09/01/AR2006090101409.html>.

Another form of economic freedom is the freedom to choose one's occupation. Although it is also a civic freedom, occupational choice means choosing what to produce and is therefore connected to economic freedom. Like the other manifestations of economic freedom we have studied, this kind of freedom also brings about the highest degree of wealth. It may seem self-evident at first; after all, the physician keeps running his surgery and the baker does not ever try out being a librarian. But conscription is one instance where this spontaneous order is interfered with. A mathematically gifted boy would hardly do as good a job as a soldier as he would as a mathematician, yet he is just as likely as anyone else to hear the call-up in countries where conscription is practised. In this way, human capital is gravely misallocated by this form of state-intervention.

It follows from the above paragraph that individuals know their interests better than do third parties. When property and individual are separated, it becomes rational for the individual to be careless with said property. A recent report suggest that the earth's oceans may soon run out of fish<sup>27</sup> and that is no surprise considering nobody actually owns the oceans. This is the tragedy of the commons; when something is not owned by anyone, it cannot be controlled. This is also why there could be a famine in Soviet Russia, despite the existence of vast, fertile lands of the Ukraine. When farm output bears no relation to farmers, there is no reason why rational farmers should care about the crops.

Man is no tool for others to use, nor is he out of altruism willing to be used. The only way in which he can work for others is if he thereby can further himself. As Adam Smith wrote: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our necessities, but of their advantages"<sup>28</sup>. The free market is the best way of channelling man's self-love into productive use. Freedom works.

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<sup>27</sup> Report: *Seafood faces collapse by 2048*, CNN, the 3<sup>rd</sup> November 2006: <http://www.cnn.com/2006/TECH/science/11/02/seafood.crisis.ap/index.html>.

<sup>28</sup> Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Edinburgh (1863), p. 7.

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