

II

... and it's no coincidence!

## That's capitalism for you!

The growth of world prosperity is not a “miracle” or any of these other mystifying terms we customarily apply to countries which have succeeded economically and socially. No schools are built or incomes generated by sheer luck like a bolt from the blue. These things happen due to people thinking along new lines and working hard to bring their ideas to fruition. But people do that everywhere, and there is no God-given reason why certain people in certain places during certain periods in history should be smarter and more capable than others. The main distinguishing factor is whether the environment permits and encourages ideas and work or puts obstacles in their way and tries to exploit the work to its own ends. That depends on whether people are allowed the liberty and possibility of exploring their way ahead, whether they are allowed to own property, invest in the long term, conclude agreements and trade with others. In short, it depends on whether or not they have capitalism. In the affluent world we have had capitalism in one form or another for a couple of hundred years. That is why we are called “the affluent world”, because it is capitalism that has given people the liberty and motive forces to create, produce and trade, thereby generating prosperity.

During the past two decades this system has spread throughout the world, in the process termed globalisation. The communist dictatorships in the east and the military dictatorships of the Third World collapsed, and the walls they had raised against ideas, people and goods collapsed with them. Instead ideas have been disseminated which say that creativity cannot be centralised, that it can only be encouraged by entitling citizens to decide for themselves, to create, to think, to work.

Capitalism means that no one is being subjected to outward coercion. We can refrain from signing contracts or doing business deals if we prefer some other solution. And so the only way of getting rich in a free market is by giving people something they want, so that they will pay for it of their own free will. Both parties have to feel that they benefit, otherwise there won't be any deal. Economics, then, is not a zero sum game. Simplifying rather, the bigger a person's income in a market economy, the more that person has done to offer people what they want. Bill Gates and Madonna earn millions and millions, but they don't pinch the money, they earn it by offering software and music which a lot of people think are worth paying for. In this sense they are essentially "servants". In this kind of situation, firms and individuals will struggle to develop better goods and more efficient ways of providing for our needs. The alternative is for the government to take our resources and then decide which types of behaviour to encourage. The only question is why the government knows better than ourselves what we want and what we consider important in our lives.

Prices and profits in a market economy serve as a signalling system which the worker, the entrepreneur and the investor can navigate by. Those who want to earn good wages or make a good profit have to make their way into those parts of the economy where they can best cater to other people's demands. Excessive taxes and handouts pervert these motive forces completely. Price controls are destructive, because they directly distort the necessary price signals. If the government puts a ceiling on prices – that is, imposes a lower price than the market would have done, as for example in the case of rental flats in central Stockholm locations – a shortage will result. People will hang onto the flats they have the tenancy of, even if they don't need them for the moment, and housing companies will stop building. Result: housing shortage. If instead the government puts a floor to prices – that is, imposes a higher price than the market would have done – this will cause surplus. When the EU pays more for foodstuffs than the

market, more people than necessary will go in for farming, resulting in surplus production (to be dumped in the developing countries).

But capitalism also requires people to be allowed to retain the resources they earn and create. If you exert yourself and invest for the long term but someone else appropriates most of the profit, the odds are you will give up. Protection of ownership lies at the very heart of a capitalist economy, not only entitling people to the fruits of their labours but also making them free to use their resources without having to ask the authorities first. Capitalism allows people to explore their own way ahead.

This is not to say that someone in the market is necessarily smarter than a bureaucrat, but he is in direct touch with the market and, through the movement of prices, has direct feedback on supply and demand. A centraliser can never collect all this information from all fields, nor is he anywhere near as motivated to be guided by it. And even if one person in the market is no smarter than a bureaucrat, a million people together certainly are! One million different attempts are generally wiser than a single, centralised solution. If the government decides that all resources are to be committed to a certain kind of collective farming and this fails, the whole of society will be economically affected and, if the worst comes to the worst, will starve. If one group of people go in for the same type of farming, e.g. in enterprise form, they alone will suffer the adverse effects if the enterprise fails. A society needs this kind of experimentation and new solutions in order to develop, but at the same time the risks entailed have to be limited, so that the whole edifice of society will not be jeopardised by a few people's mistakes. Therein lies the excellence of individual decision-making and individual responsibility. Personal responsibility, not least, is of the essence. A politician or bureaucrat handling huge sums of money for things like infrastructure investments or campaigning to host the next Olympics is not under the same pressure as entrepreneurs and investors to make rational decisions. If things go wrong and

expenditure exceeds income, it isn't the politician who foots the bill.

People who own their property act on a long-term basis, in the knowledge that they will harvest the fruits of their actions. This is the kernel of a capitalist economy – people saving part of what they already have, so as to create more value for the future. This is the same process as when we devote some of our time and energy today to getting a good education which will pay bigger dividends in the long run (“human capital”). In the economy this means that, instead of living from hand to mouth we set aside part of what we have and are rewarded with interest or profits by whoever can use the money more efficiently than we can ourselves. This saving and investment elevates the economy to progressively higher levels. It also finances new machinery and organisational structures to make the workforce more productive.

Organisation is important, because through voluntary co-operation people can produce more than they would by doing everything single-handed. It may take a single craftsman a week to produce a chair, but if he is best at the structure itself and joins forces with someone who can paint and someone who is good at sewing chair cushions, together they can perhaps turn out one chair a day. Given modern machinery they can make a hundred chairs a day. This augments the value of their labour.

Technical progress enabled new machines to manufacture old types of goods less expensively, placing new inventions and goods at people's disposal. As a result of this ongoing improvement of productivity through the division of labour and technical advances, one hour's labour today is worth about 25 times more than it was in the mid-19th century. Employees, consequently, now receive about 25 times as much as they did then, in the form of better pay, better working conditions and shorter working hours. When a person's labour grows more valuable, more firms want to buy it, and to get hold of manpower they then have to raise wages and improve the work situation. If instead wages are increased more rapidly than productivity, through

legislation or collective agreements, then jobs will have to go, because the workers' input is not worth what the employer is forced to pay for it. Alternatively one can do as the politicians did for a long time in Sweden – obliterate pay rises by accelerating inflation, so that everyone can keep their jobs. If so, pay hikes will of course be a chimera. Growth and productivity alone are capable of raising real wages in the long run.

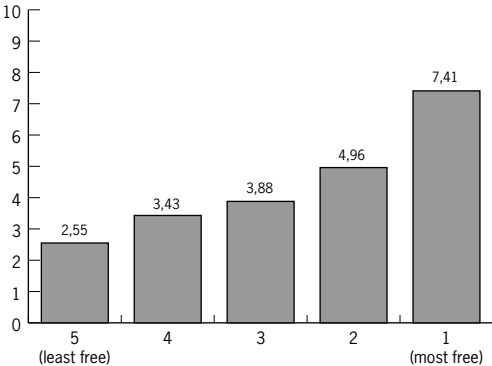
All political and economic systems need rules, and this includes even the most liberal capitalism, which presupposes rules defining legitimate ownership, rules on the writing of contracts, the resolution of disputes and many other matters. These rules are needed in order for the market economy to be workable. But there are also rules which prevent the market economy from working – detailed regulations deciding what use people can make of their property and making it difficult to start up a certain kind of activity, owing to the need for licences and permits or restrictive rules on pricing and business transactions. These regulations mainly serve to give more power over the economy to public authorities which are not themselves a part of it and which have not risked their own money. They add up to a heavy burden on the creators of our prosperity. In Sweden alone, entrepreneurs have about 20,000 rules to keep tabs on. Little wonder, then, that more people do not translate their good ideas into entrepreneurial activity.

These rules are also harmful in another way. Impediments to necessary activity result in a large part of a firm's time being devoted to circumventing the rules – time which could otherwise be devoted to production. If this is too difficult, people join the informal economy instead, thereby depriving themselves of legal protection for their business dealings. Many firms will use their resources to coax politicians into adapting the rules to their needs – resources which could otherwise have been used for investment. Many will be tempted to take shortcuts, and bureaucrats will oblige in return for generous bribes,

especially in poor countries where salaries are low and regulatory systems more or less chaotic. The commonest way of corrupting a nation through and through is by stipulating permits and controls for production, for imports, for exports, for investments. More than two and a half millennia ago, the Oriental teacher Lao-tse declared: "The more laws that are made, the more numerous thieves and bandits become."

### Economic freedom reduces corruption

Freedom from corruption, by Transparency International's rating (1 most corruption, 10 least corruption)



The countries of the world, divided into fifths by degrees of economic freedom.

Source: Gwartney & Lawson et al., 2001.

For restoring honest rules and incorruptible officials, there is no better way than substantial deregulation. Amartya Sen finds in the struggle against corruption a perfectly adequate reason for developing countries to deregulate their economies, even if no other economic benefits were to accrue from so doing.<sup>24</sup>

24. Sen 1999, p. 276.

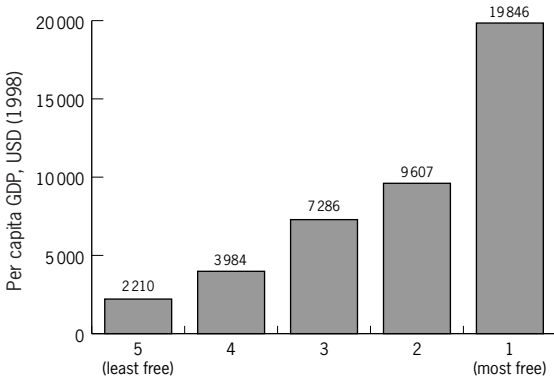
## Growth – a blessing

All experience indicates that it is in liberal régimes that wealth is created and development sustained. Politics and economics are not exact sciences. We cannot perform laboratory experiments in order to ascertain which systems work and which do not, but no social phenomenon comes closer than capitalism to achieving this very thing. There are a number of instances of a similar population, with similar pre-conditions and sharing the same language and norms, being subjected to two different systems, one a market economy and the other a centrally controlled command economy. Thus with Germany divided into capitalist West and communist East, there was talk of an economic miracle in the western part, which in the end had to foot the entire bill for reunification with the ramshackle eastern part, even though the latter was the wealthiest among its Eastern European peers. The same thing happened with capitalist South Korea and communist North Korea. The former was numbered among the Asian tigers, convincing the world that developing countries *can* develop. Whereas in the 1960s it was as poor as Bangladesh, today, with the world's tenth largest economy, it is almost as affluent as a Western European country. The North Korean economy, by contrast, underwent a total collapse, and the country is now afflicted with mass starvation. One can also see the difference between Taiwan, a market economy, which has experienced one of the swiftest economic developments in history, and communist mainland China, which suffered starvation and misery until it saw fit to start opening up its markets.

The same comparison is visible all over the world. The greater the degree of economic liberalism in a country, the more chance that

country has of attaining higher prosperity, faster growth, a higher standard of living and higher average life expectancy. People in the economically freest countries are nearly ten times as rich as those in the least free, and they are living more than twenty years longer!

### Economic freedom brings prosperity

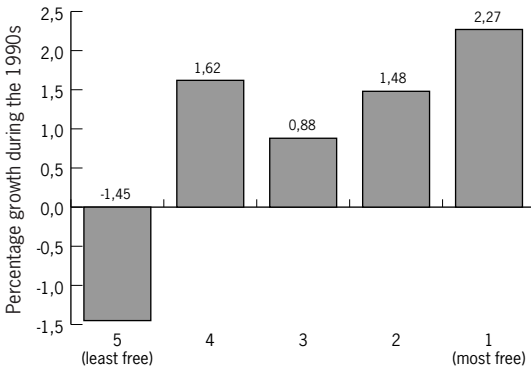


The countries of the world, divided into fifths by degrees of economic freedom.

Source: Gwartney & Lawson et al., 2001.<sup>25</sup>

25. These charts, of course, do not distinguish between cause and effect. They could be compatible with countries first growing rich and then starting to liberalise the economy. This is a material factor, but looking at the countries concealed by these figures, one finds that the relation mainly operates in the contrary direction, i.e. that liberalisation measures are accompanied by growth. Nothing I have to say here should be taken to imply that history, culture and other factors make no difference to national development. On the contrary, I believe, for example, that people's ideas and convictions are of momentous import for economic development, but I have concentrated here on the political factors, which of course also impact people's motive forces.

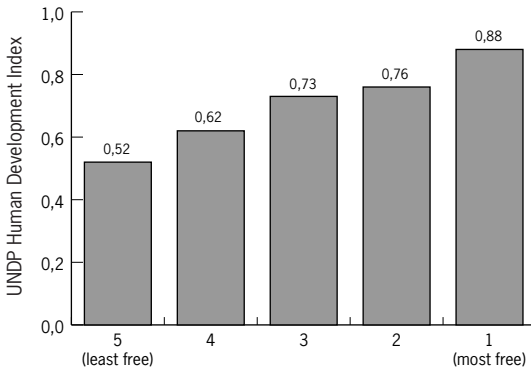
## Economic freedom brings growth



The countries of the world, divided into fifths by degrees of economic freedom.

Source: Gwartney & Lawson et al., 2001.

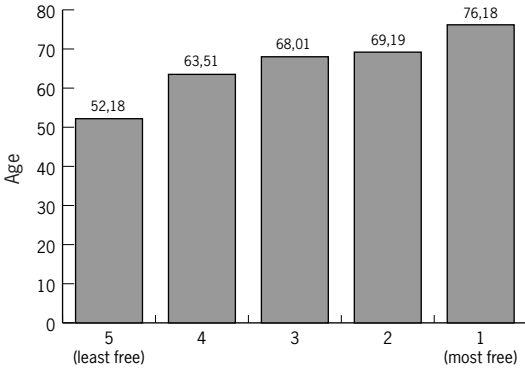
## Economic freedom raises living standards



The countries of the world, divided into fifths by degrees of economic freedom.

Source: Gwartney & Lawson et al., 2001.

## Economic freedom increases average life expectancy



The countries of the world, divided into fifths by degrees of economic freedom.

Source: Gwartney & Lawson et al., 2001.

The economic development of the past two centuries has no counterpart prior to the breakthrough of the market economy in the 19th century. Historically, the normal state of affairs was for people to be more or less destitute, surviving from one day to the next. The medieval European was often chronically undernourished and worked, in his or her one and only article of clothing, in houses which were so filthy and verminous that, in the words of a historian: “From a health point of view the only thing to be said in their favour was that they burnt down very easily!”<sup>26</sup> After the 16th century, when different parts of the world, very slowly and tentatively, began trading with each other, we do find examples of growth, but it was marginal in the extreme.

<sup>26</sup> Buer, cit. Rand 197, p. 114.

Poverty in the 18th century was much the same on every continent. According to highly uncertain estimates, Europe was only 20 per cent wealthier than the rest of the world. Then, 180 years ago, in about 1820, Europe, as a result of the Industrial Revolution, began moving further ahead. But poverty remained appalling. Per capita income in the very richest European countries was between 1,000 and 1,500 dollars – roughly the same level as in present-day Bolivia or Kazakhstan. Even if all incomes had been perfectly equally distributed, this would still have been insufficient for more than a state of abject misery, with neither clean water nor daily bread and with little more than one garment or so per person. About 75 per cent of the world's population lived in extreme poverty. These are levels which today are scarcely to be seen anywhere in the world: only the very poorest countries – Mali, Zambia and Nigeria, for example – come anywhere near them. During the 200 years since then, per capita incomes have multiplied several times over, worldwide. Global growth during the 320 years between 1500 and 1820 has been estimated at a mere thirtieth of what the world has experienced since then.<sup>27</sup> Since then, incomes in Europe have multiplied more than ten times over. Asia too has put on speed during the past half-century and, the path to prosperity being already known, has trodden it still faster. Living standards today, compared with 1950, are eight times higher in Japan and six times higher in China.

Increased investments and the urge to devise better, more efficient solutions to old problems enable us to produce more, and growth accelerates. This generates new ideas and machinery, enabling the workforce to produce more. GDP – gross domestic product – is a measure of the value of all goods and services produced in a country. Investigating this value per inhabitant of a country – *per capita*, “per head” – we can roughly gauge that country's wealth. Growth – our

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27. Maddison, 1995.

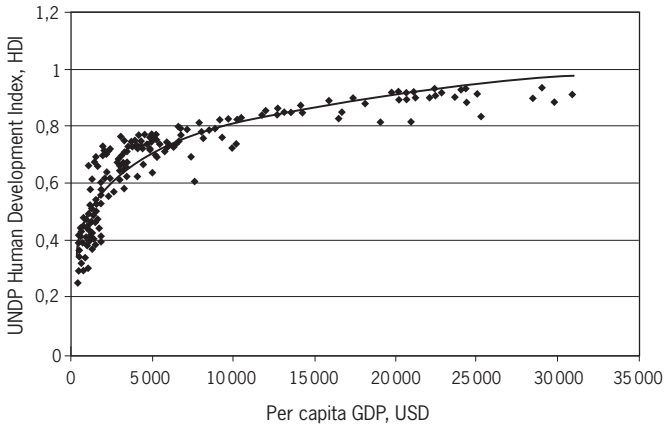
producing more goods and services – may not sound the most exciting thing on earth in everybody’s ears, and certain radical circles have even come to disdain it, branding those who do care about it as “economistic” or “growth fanatics”. This may be partly a healthy reaction to some people having begun to see high GDP as an end in itself, but growth, quite simply, means that production grows, and prosperity and opportunities with it. In our affluent world it may be the prerequisite for starting to save, to consume more, to invest in welfare or, quite simply, to work less for the same payment. In the developing countries it can mean the difference between life and death, development and stagnation, for it is growth that can provide scope for healthy foodstuffs and pure drinking water.<sup>28</sup>

For everyday living in India, growth since the 1980s has meant mud huts being superseded by brick buildings and muddy paths being paved and asphalted. Radios have become widespread, and 40 per cent of the population now have access to television. Electricity has become everyman’s property and the dark alleys now have street lighting. Those alleys no longer reek of garbage, and hotbeds of infection are removed by proper drainage. Even the poor can afford clothing and footwear. As the clearest example of what growth implies, the Indian woman no longer washes half her sari at a time. Time was when she had to, because she only possessed one and thus had to wash it while still wearing it.

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28. The view of growth as an end in itself is absurd. That way, the important thing would be just producing as much as possible. That kind of growth is easily created by the state taking everyone’s money and starting up an enormous output of things which people don’t want. As for example with steel and munitions in the Soviet Union. Growth has to take place on people’s terms, i.e. by producing things which people are demanding. That is why, fundamentally, it is only in a market economy, where demand impacts on prices and production, that growth can really take place in fields where people benefit.

## Incomes and living standards go hand in hand



Source: Melchoir, Telle & Wiig, 2000, p. 96.

Growth also means opportunities and power for people. It means that, instead of resorting to the local usurer and getting into debt for a lifetime, the ordinary Indian can turn to a bank instead. People can look for jobs in different places, with different entrepreneurs, which emancipates the poor from the power of life and death which the village landlord once had over them. Although India has had democratic elections, they do not make all that much difference so long as the poor are completely at the beck and call of the local élite, because then they still have to vote as they are told. Parents in the poor part of the world do not send their children out to work because they like doing it, but because they need the money to feed the family. Growth gives them better incomes and improves the return on education, which means they can send their children to school instead. This also gives the individual greater opportunity within the family. A law against wife beating can be ineffective if the woman is economically depen-

dent on her husband for survival, because in that case she will neither report him nor leave him. When the economy grows and more production materialises, the woman has a chance of getting a job away from home. She becomes less dependent on the husband's caprices.

“In my mother's day women had to grin and bear it. I wouldn't have any of it. I can speak my mind. Life isn't just meant to be sacrifice, you also have to be able to enjoy it. That, I think, is the great change that is happening in Japan. People no longer want to work and work. Today they also want to have time for a good life and a little enjoyment.”

*29-year-old Japanese Eriklo, who instead of following in her parents' footsteps and working on the land became an advertising artist.*<sup>29</sup>

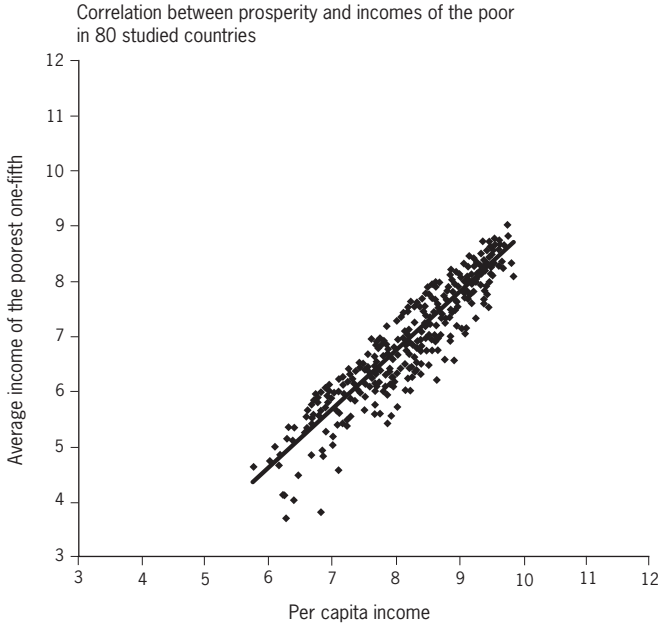
It is sometimes argued that growth only benefits the rich, while the poor of society lag behind. This is a curious notion. Why should poor people benefit less than others from society growing richer? Two World Bank economists, David Dollar and Aart Kraay, studied 40 years' income statistics from 80 countries to see whether this was really true. Their studies show that growth benefits the poor just as much as the rich. With 1 per cent growth the poor increase their income on average by 1 per cent, with 10 per cent growth they raise it, on average, by 10 per cent. Not always and not everywhere – there are exceptions and variations – but on average. This finding tallies with a long line of other surveys, whereas studies suggesting the contrary are very hard to find.<sup>30</sup>

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29. Berg & Karlsson 2000, p. 245.

30. Dollar & Kraay 2000a. For a balanced review of the debate on this report, see Vlachos 2000. Reports corroborating these findings include Gallup, Radelet & Warner 1998, suggesting that in proportional terms the poor actually benefit more from growth than other groups.

## Growth benefits the poor

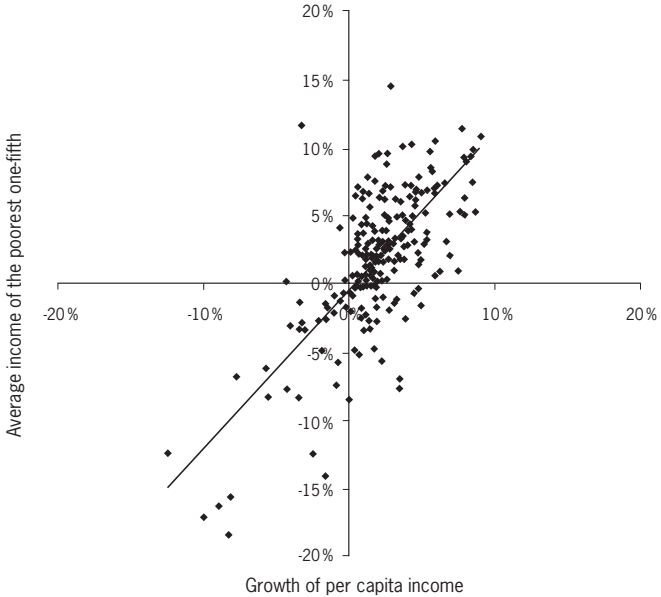


Source: Dollar & Kraay, 2000a.

This makes growth the best cure for poverty. Some economists have spoken of a “trickle-down” effect, in the sense of some taking the lead and getting rich first, after which parts of this wealth trickle down to the poor, as a result of the rich demanding their labour. This thesis rather reminds one of the image of the poor man getting the crumbs that fall from the rich man’s table, but this is a completely mistaken picture of the true effect of growth. On the contrary, what happens is that the poor derive benefit from growth to roughly the same extent

## Growth benefits the poor

Correlation between economic growth and incomes of the poor in 80 studied countries



Source: Dollar & Kraay, 2000a.

and at the same speed as the rich. They benefit immediately from the value of their labour increasing and from the goods they buy becoming cheaper in relation to their income.

No country has ever succeeded in reducing poverty without having long-term growth. Nor is there any case of the opposite, i.e. of a country having had long-term sustainable growth which has not been of benefit to the poor population. Still more interestingly, there is no instance of a country having had steady levels of growth in the long

term without opening up its markets. The World Bank's latest *World Development Report* contains a good deal of rhetoric about growth not being everything and not being sufficient for development – influenced, no doubt, by the growth of the anti-globalisation movement. But at the same time the tables in the report show that, the higher a country's growth has been in the past twenty years, the faster it has reduced poverty, infant mortality and illiteracy. In the countries at the bottom of the growth league, illiteracy had actually increased. It is possible that growth in itself is not sufficient to bring good development for everyone, but growth is manifestly necessary.

If we have 3 per cent growth per annum, this means that the economy, our capital and our incomes double every 23 years. If growth is twice as fast, these things double about every 12 years. This is an unparalleled growth of prosperity, compared with which even vigorous government measures for the redistribution of incomes take on a puny aspect. And not just puny, but downright dangerous, because high taxes to finance these measures can jeopardise growth. If so, great long-term benefits for everyone are sacrificed in favour of small immediate gains for a few.

A society's economy is above all improved by people saving, investing and working. High taxes on work, savings and capital are therefore, in the words of John Stuart Mill: "to impose a penalty on people for having worked harder and saved more than their neighbours." That means punishing what is most beneficial to society. Or, as somebody has put it: "Fines are a kind of tax for doing wrong, tax is a kind of fine for doing right." We have alcohol taxes to reduce consumption of alcohol, tobacco taxes to reduce smoking and environmental taxes to reduce pollution. So where do we expect the taxation of endeavour, work and saving to get us? It results in many people not exerting themselves top work, invest and hatch new ideas, because most of the proceeds will go to the government. It leads to firms devoting more and more time to tax evasion, time which they could have devoted to

constructive work. It leads to people spending more time on things they are not good at. The surgeon stays at home and redecorates the living room instead of doing what he is best at – saving life – because that way he avoids having to pay tax on his own work and pay tax on the painter's wages.<sup>31</sup>

In a dynamic market economy there is also social mobility. Someone who is poor today will not necessarily be poor tomorrow. In the absence of fixed privileges and high taxes, there are great possibilities of raising one's standard of living through one's own exertions, education and thrift. Four-fifths of America's millionaires have made their money themselves, as opposed to just coming into it.

The poorest one-fifth in a capitalist economy like America's earn, it is true, only 3.6 per cent of the country's GDP, a share which does not appear to increase. But by viewing income gaps in these static terms one forgets that there is always mobility within the various groups – upward mobility. Partly because wages rise with higher education and longer working experience. Only 5.1 per cent of the Americans belonging to the poorest one-fifth in 1975 still did so in 1991. In the meantime nearly 30 per cent of them had moved up into the wealthiest one-fifth and altogether 60 per cent of them had arrived in one of the wealthiest two-fifths. By 1991 the people belonging in 1975 to the poorest fifth had raised their annual income (which at that time was only 1,263 dollars in 1997 prices) by no less than 27,745 dollars, which in absolute figures is more than six times the increase obtained by the wealthiest one-fifth.

So the best cure for poverty is having a chance of doing something about it. On average, those falling below the poverty line in the USA

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31. See Åsa Hansson's Ph.D. thesis *Limits of Tax Policy*, suggesting that if the pressure of taxation rises by one percentage unit in a developed industrial nation, annual growth declines by roughly 0.23 percentage unit. The digest of research presented in Leufstedt & Voltaire 1998 suggests that a growth of the public sector by 10 percentage units reduces growth by about 1.5 percentage units.

only stay there for 4.2 months. Only 4 per cent of America's population are long-term poor, i.e. remain poor for over two years. Meanwhile the poorest fifth is replenished with new people – students and immigrants – who then climb up the ladder of wealth.<sup>32</sup>

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32. Cox & Alm 1999, chap. 4. Some have argued that this social mobility is greater in a more egalitarian country, like Sweden, despite heavier pressure of taxation, but this is probably due to a confusion of concepts. It is easier to enter a new income band in Sweden, because pay differentials are so small here, but on the other hand it is more difficult to raise one's earnings in shillings and pence.

## Freedom or equality?

### Why choose?

Many believe that liberalisation and economic growth imply a growth of inequality in a society. Once again I would like to point out that this is not the crux of the matter. The important thing should be how well situated you are, not how well situated you are in relation to others. The important thing is for as many people as possible to be better off, and this is not a bad result merely because some people improve their lot still faster than others. But there are several reasons why equality is worth aiming for. For one thing, it is appealing that people should not get off to tremendously unequal starts in life. It is important that everyone should have similar opportunities – not so important that it is worth reducing everyone's chances in order to make them as equal as possible, but still important enough for great social inequality to be a problem. This, then, is an important objection to scrutinise.

Another reason is that equality actually stimulates growth, quite contrary to what is often claimed. True, in a very poor society some degree of inequality may be necessary in order for anyone at all to be able to start saving and investing, but many studies have shown that, on average, societies with a high degree of equality achieve, on average, greater economic growth than unequal societies, especially if the inequality concerns land ownership. One reason for this connection is that governments with greater equality can be expected to have greater stability and less political turbulence. Inequality can lead to conflicts, or demands for higher taxes and more distributive policy, which are threats to growth.

But a more important reason is that people must have a certain measure of basic assets – land, for example, in an undeveloped economy, and education in a modern one – to be able to work efficiently and develop society. What matters, then, is a degree of equality in terms of assets, and not what is usually meant in the political debate, e.g. equality of incomes and profits. Thus the important thing in a developing country which has ancient, unfair feudal structures and where a small élite owns the land is land reforms, so that more people will have a share of the land and will thus be able to participate in the economy. The important thing is for the whole population to obtain education and all of them to have good opportunities of borrowing money if they have ideas for business projects. No one must be discriminated against or marginalized, or prevented by licensing requirements, prohibitions and privileges from competing for positions and incomes. This kind of equality spurs the dynamic of the economy, whereas a reallocation of incomes if anything reduces it, because then education, work and the introduction of new ideas become less profitable.

Simplifying matters somewhat, it is equality of opportunity that matters, not equality of results. The important thing is for everyone to have certain basic opportunities and then be at liberty to explore their way forward and achieve different results. These are two sides of the same coin: people have the opportunity of working and exploring their way ahead, and the right to make a profit out of the enterprise if it does well. This results in a society which encourages social mobility and rewards initiative and effort, and consequently also achieves greater prosperity. Thus it is not income differences in themselves that are dangerous for development, but the discrimination and privileges which cause the difference in incomes in undemocratic states. This is corroborated by the connection between equality and growth being clear in non-democratic states but not demonstrable in modern, liberal ones.<sup>33</sup>

But can the opposite also apply, namely that increased growth leads to greater inequality, as is widely maintained? Economists sometimes refer to “Kuznet’s inverted U-curve”, which is based on an article by the economist Simon Kuznet, published in 1955, arguing that economic growth in a society initially leads to greater inequality and only after some time leads to a reduction of inequality. Many have accepted this thesis as truth and it is sometimes used to discredit the idea of growth, or at least to demand a national distributive policy. Kuznet himself did not draw any such drastic conclusions. On the contrary, he declared that his article was based on “perhaps 5 per cent empirical information and 95 per cent speculation”, adding that “so long as it is recognized as a collection of hunches calling for further investigation rather than a set of fully tested conclusions, little harm and much good may result”.<sup>34</sup>

If we follow Kuznet’s recommendation and investigate what has happened since the 1950s, we can see that his preliminary conclusion is not universally valid. True, it can happen that growth initially leads to inequality, but this is not a general connection. There are countries which have had high growth leading to a reduction of income differences, e.g. Indonesia, Malaysia, Taiwan, South Korea and Mauritius, and there are countries like China, Thailand, Pakistan and Brazil where growth has entailed greater income differences. Similarly, things have moved in different directions in countries with low or negative growth. Equality has increased in Cuba, Colombia and Morocco, while diminishing in Kenya, Ethiopia and Mexico during the 80s and Russia during the 90s. Distribution hinges on other

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33. Concerning equality of assets versus equality of income, see Deininger & Olinto 2000, for the connection with democracy, see Deininger & Squire 1998.

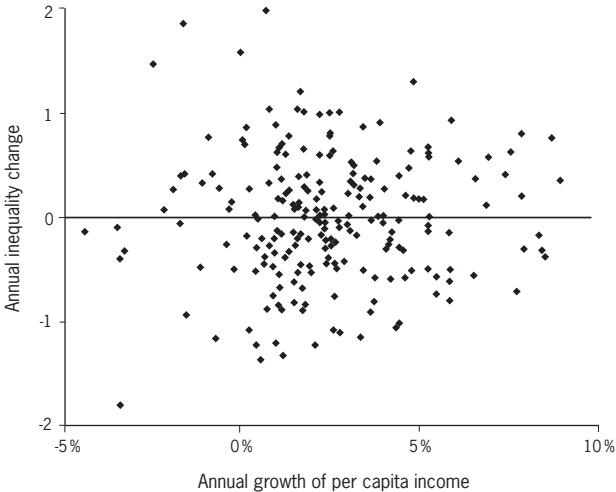
34. Kuznet 1955, p. 26.

aspects, such as initial position and domestic policy. The World Bank sums up the state of affairs by saying:

*The available statistics do not indicate a stable relation between growth and inequality. On average, inequality within countries has neither diminished nor increased during the past 30 years.<sup>35</sup>*

### **Economic growth does not increase inequality**

Correlation between economic growth and inequality in 80 studied countries

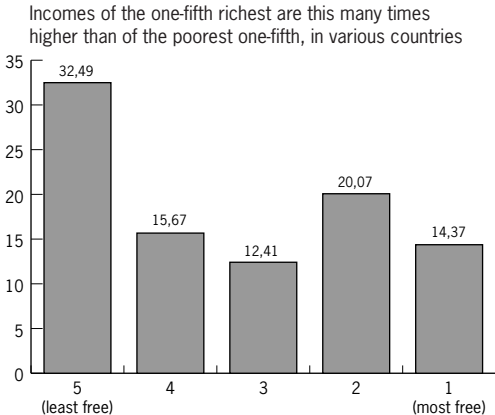


Source: Dollar & Kraay, 2000a.

35. World Bank 2000c. The data refuting Kuznet are presented in Deininger & Squire 1998, pp. 259–287. For a review of the research, see Bigsten & Levin 2000.

Studying equality in 70 countries, the economist G. W. Scully found that incomes were *more evenly distributed* in countries with a liberal economy, open markets and property rights. This was above all because the middle class had more and the upper class less in free than in unfree economies. The share of national income going to the richest fifth of the population was 25 per cent lower in “freest” economies than in “least free” economies. The proportion going to the poorest fifth in a society was unaffected by how free the economy was, but their actual incomes were far greater in liberal economies.<sup>36</sup>

### Economic freedom increases equality



The countries of the world, divided into fifths by degrees of economic freedom.

Source: Gwartney & Lawson et al., 2000.

36. Scully 1992.

Thus, quite contrary to the popular supposition, a higher degree of economic liberalism appears to mean more economic equality. But this tells us nothing about the effect of changes in equality. Perhaps rapid liberalisation programmes and changes of system can have a negative impact on equality? But not even this seems to fit. The Swedish economist Niclas Berggren has investigated how a growth of economic freedom affects economic equality. In countries which have liberalised their economies since 1985, equality has *increased*, while stagnating or diminishing in countries which have refrained from liberalisation. Equality is growing fastest in poor developing countries which are quickly reforming their economies. Berggren's findings indicate that there are above all two aspects which increase equality in a society: freedom of international trade and freedom of international movements of capital – the two most “globalising” reforms.<sup>37</sup>

This pattern is corroborated by a different classification of countries, namely one measuring how “globalised” they are. A.T. Kearny and Foreign Policy have tried to devise a “globalisation index”, an estimate of how much a country's inhabitants shop, invest, communicate and travel across its boundaries. The globalised countries, one finds, are not at all more unequal. On the contrary:

*The general pattern of higher globalization and greater income equality holds for most countries, both in mature economies and emerging markets.*<sup>38</sup>

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37. Niclas Berggren 1999.

38. “Measuring Globalization”, *Foreign Policy*, Jan./Feb. 2001. The most globalised country in the world according to this index is little Singapore, just ahead of the Netherlands and Sweden. A country like the USA only comes twelfth. But this is partly an illusion, the USA being so big as to accommodate far more long-distance travel, trade and communication within its frontiers than small countries.

Liberals and socialists both usually say that individual liberty and economic equality are each other's opposites, thus explaining why they oppose one of these widely appreciated values. They may be right in the sense of choosing to focus on one value or the other in their policy-making, but it is not true to say that the two values are contradictory. On the contrary, there is much to suggest that equality of liberty also confers economic equality. Rights of ownership, freedom of enterprise, free trade and reduced inflation confer both growth and equality.

## Property rights – for the sake of the poor

That economic freedom is not an enemy of equality comes as a surprise to everyone who has been told that capitalism is the ideology of the rich and the privileged. In fact the opposite applies. The free market is the antithesis of societies of privilege. In a market economy the only way of retaining a good economic position is by improving your production and offering people good products or services. It is in the regulated economies, with their distribution of privileges and monopolies to favoured groups, that the prevailing conditions are cemented. Those who have the right contacts, can afford to pay bribes and have the time and knowledge to plough through bulky volumes of regulations can start up business enterprises and engage in trade. The poor never have a chance, not even of starting rudimentary businesses like a bakery or a corner shop. In a capitalist society anyone with ideas and willpower is at liberty to try their luck, even if they are not the favourites of the rulers.

Globalisation is especially important from this point of view, because it disturbs power relations and emancipates people from the local potentates. Free trade enables consumers to buy goods and choose solutions from others instead of the local monopolists, free movements of capital also enable poor people with good ideas to finance business ideas and projects. Freedom of establishment means that the village's one and only employer has to offer higher wages and better working conditions in order to attract labour, because otherwise the workers can go elsewhere.

The left often portrays liberalism as the ideology of the rich, because it stands up for rights of ownership. But defending private pro-

erty is not the same as cementing the prevailing property conditions. Empirical facts tell us that it is not mainly the rich who benefit from the protection of property rights. On the contrary, it may be the most vulnerable citizens who have most to lose in a society without stable rights of ownership, because then it is the people with most political power and contacts who manage best and lay hold on resources. Where there is private property, resources and incomes are channelled mainly to those who are productive and who offer services in the market and the workplace, and underprivileged groups then have a much better chance of asserting themselves than in a system governed by power and graft. Besides, it is they who have most to gain from goods becoming progressively cheaper in relation to incomes, which competition based on rights of ownership helps to make them. Above all, property rights provide an opportunity of foresight and personal initiative, spurring growth and distributing the fruits of it equally, on average, between rich and poor. Thus the introduction of safeguards for private property in a society has a distributive effect as favourable to the poor as commitment to universal education. Nor are things made worse by ownership safeguards apparently also being the reform most conducive to growth.<sup>39</sup>

The Peruvian economist Hernando de Soto has done more than anyone else to show how poor people lose by the absence of property rights. In his revolutionary book *The Mystery of Capital* he turns the view of the world's poor upside down. The problem is not that they are helpless or unpropertied, but that they have no rights of ownership. In fact they are people with great powers of initiative who save large parts of their income which they then spend on improving their land and their homes. After many years spent travelling and researching, he roughly estimates that poor people in the Third World and

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39. Cf. Dollar & Kraay 2000b and 2000a. Concerning the importance of property rights for economic development, see Rosenberg & Birdzell Jr 1991.

in former communist states have real estate (buildings and the land they stand on) worth about 9.3 billion dollars more than is officially registered. This is a huge sum, almost equalling the combined value of all companies listed on the stock exchanges of the affluent countries – New York, Nasdaq, Toronto, Tokyo, London, Frankfurt, Paris, Milan – and a dozen more besides. But the problem is that the governments do not accept these rights of ownership without tortuous bureaucratic processes. People in the Third World occupy common lands, build simple houses in shanty towns which they are constantly improving, and establish small corner shops, just as poor people in the western world were doing a couple of hundred years ago. The trouble is that in developing countries today it is practically impossible to register this as property. De Soto illustrates these problems through an ambitious experiment. Together with a number of colleagues he travelled the world, attempting to register property. The results are horrifying.

Obtaining legal title to a house built on public land in Peru required 207 different administrative steps at 52 different public offices. Anyone wishing to do something as simple as driving a taxi or starting a private bus service legally could expect 26 months of red tape first. In Haiti people can only settle on a common by leasing the land for five years and then buying it. But just getting a leasehold permit involved 65 steps, taking over two years. Buying the freehold then took far longer. In the Philippines the same thing could take over 13 years. Legally registering a plot of land in the Egyptian desert required permits from 31 authorities, which could take between 5 and 14 years, and doing the same for agricultural land took between 6 and 11 years.

Getting a legal licence for a factory with two sewing machines in the shanty towns of Lima occupied 289 six-hour days of travelling to the authorities, queuing up to see the right people, filling in forms and waiting for an answer, added to which the process cost a total of

1,231 dollars – more than thirty times the minimum monthly wage.

To people without big resources or powerful contacts, these are insuperable barriers. And so poor people are forced to live and run micro-businesses in the informal sector, outside the law. Consequently they have no legal protection and do not dare to invest for the long term, even if they can. Their property is not included in a uniform system of ownership which follows transactions and indicates one owner. Without clarity as to who owns what, how transactions are to proceed, who is responsible for payments and services to the address, the property remains “dead capital”. Properties cannot be mortgaged, which would otherwise provide capital for financing the children’s education or investments and expansion of the business. Thus the commonest way for small entrepreneurs in affluent countries to obtain capital is cut off in developing countries. Without a registered address and the possibility of having one’s creditworthiness investigated, it is often impossible to get a phone or water and electricity supply, and the property cannot even be sold.

Nor can the entrepreneurs expand their business by selling shares in it. Owners of micro-businesses, being forced to work in the informal sector, always have to beware of bureaucrats and the police, or else pay heavy bribes. So they have to keep the business small and hidden, and are thus debarred from economies of scale. Nor do they dare to advertise or to broaden their customer base excessively. They venture to sell to the nearest precincts, but no more. Big deals can only be concluded with members of the family and with people one trusts.

De Soto maintains that between 50 and 75 per cent of citizens in the developing countries work outside the protection of the law, and that roughly 80 per cent of homes and land are not registered in the name of their present owners. In one country he visited the urban authority itself had established an illegal settlement on common land so that its employees would have somewhere to live. So the great

majority of the population have assets which they are not allowed to make full use of. In the absence of rights of ownership they cannot use their property as a basis of expansion, which was the western world's path to prosperity. Only an élite in the developing countries have contacts permitting them to engage in modern economic activity. Capitalism without property rights becomes capitalism for the élite only. Millions of capable people with powers of initiative who could be the entrepreneurs of the future become entrapped by poverty.<sup>40</sup>

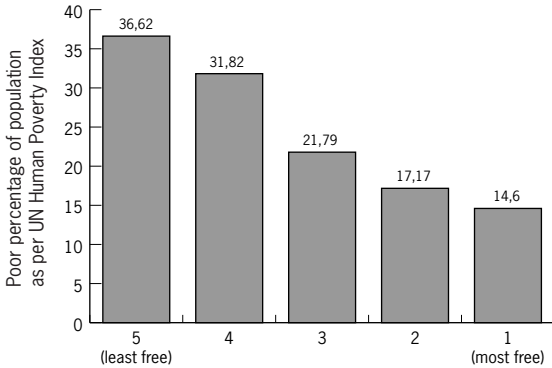
This is one of the reasons why Russia's economy has not developed during the 90s. Although communism has fallen, the Russian government has still not introduced a uniform system of private rights of land ownership. Land is generally deemed to be basically owned by the government and is just lent or leased to the farmers, with the result that investment is pointless and sale or mortgage unthinkable. Fewer than 300,000 out of a total of some 10 million Russian farmers have anything resembling title to their land. The government imposes severe restrictions on what people can do with land which really belongs to them. Land socialism, of course, inhibits any number of investment opportunities, but because land is often the basis of borrowing, it also impedes the development of a modern credit system. Instead transactions find their way into the informal market. Russia is sometimes portrayed as a kind of hypercapitalism. By all reasonable definitions of capitalism, this is nonsense. Russian land socialism, coupled with a formidable welter of business regulations and trade controls, leads the Heritage Foundation to find it only the 127th freest economy out of 155 investigated, and in Economic Freedom of the World's corresponding table it comes 117th out of 123, after countries like Syria and Rwanda.<sup>41</sup>

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40. de Soto 2000.

41. Gwartney, Lawson, Park & Skipton 2001, O'Driscoll Jr, Holmes & Kirkpatrick 2001.

## Economic freedom reduces poverty



The countries of the world, divided into fifths by degrees of economic freedom.

Source: Gwartney & Lawson et al., 2001.

Regulation of agriculture is another important cause of inequality. Through price regulations and delivery requirements, among other things, many developing countries have tried to benefit the urban population at the farmers' expense. This is part of an attempt to force industrialisation into being, by taxing and regulating agriculture in such a way that its surplus is transferred to industry. The problem is that this has had the effect of shattering agriculture, depriving it of resources which would have been needed in order to streamline food production and actually generate a surplus. In many African and Latin American countries this has created a vicious circle, with heavy migration from the impoverished countryside to the towns and cities. But there is no great demand for industrial goods, because the countryside remains poor, and so unemployment and poverty increase in the towns, and homelessness, crime and prostitution with them. The property which the poor themselves acquire and save up

for is not recognised and is not registered. As a result, demand for agricultural produce does not gather speed, and so urbanisation continues. Nor is foreign demand to be counted on, with the affluent countries constructing high tariff barriers against agricultural produce.<sup>42</sup>

There are several types of anti-liberal policy by which the poor are especially hard hit. One of them is inflation, which ruins the value of money. By rapidly increasing money supply, the government obliterates the small monetary assets of the poor, while the rich who own registered land, properties and businesses get off more lightly. Reducing inflation, and above all avoiding the kind of hyperinflation with which many Third World countries have been afflicted, is one of the most important things that can be done to help the less well-to-do, according to the World Bank report by Dollar and Kraay mentioned earlier. One classic example of hyperinflation was Germany's during the 1920s, which ruined the middle class and made people receptive to Hitler's policies. An extreme instance of the opposite occurred at the end of 1989, when Argentina quickly reduced inflation and, in little over a year, reduced the proportion of poor people in great-Buenos Aires from 35 to 23 per cent.

Another connection indicated by Dollar and Kraay's findings is that public spending seems to harm not only growth but also, and above all, a country's poorest inhabitants. This does not ring true to those who believe that public spending is the same as taking from the rich and giving to the poor. In fact the opposite frequently applies. In poor, undemocratic countries especially, it is the élite, the leader, his relatives and friends and powerful corporations that are allowed to dip into the till, while the bill is paid by those without influence in the palaces of the capital city. Oversized military establishments pre-empt the lion's share of resources. The rulers prefer to invest in prestigious international airports, universities and city hospitals rather than in

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42. Gunnarsson & Rojas 1997, pp. 50 ff.

roads, schools and local hospitals which would really help people. In undemocratic countries, moreover, public medical care and education are often directed to staunch supporters of the régime and to the most comfortably off. This goes to show how wrong many left-wing intellectuals were in the 60s and 70s when they declared that democratic rights and liberties did not matter all that much in the developing countries, because what they first needed to invest in was welfare policy. Without democracy, not even the welfare policy which actually exists will benefit the great mass of the population.

One problem is that inefficient systems of government cannot make the best possible use of money. "I've heard rumours about assistance for the poor, but no one seems to know where it is," as a poor Indonesian put it in the course of conversation. Presumably the money went into a local bigwig's pockets. The same problem exists in India, where bureaucracy and corruption have turned poor relief into black holes. Paying the poor a 1 dollar subsidy through the big programme of food subsidisation has cost the Indian government 4 dollars and 30 cents. It is of course a straight loss to the poor, their supplies being taxed so heavily in order for them to claw back a far smaller amount in the form of aid.<sup>43</sup>

Capitalism is not a perfect system, and it is not good for everyone all the time. Critics of globalisation are good at pointing out individual bad instances – a factory that has closed down, a wage that has been reduced. These things may very well be true. But by concentrating solely on individual instances one is liable to completely obscure the general realisation of how a political or economical system generally works and what fantastic values it confers on the great majority compared with other alternatives. There are seamy sides and problems to be found in all political and economic systems, but this can be no cause for rejecting all solutions. Hunting down negative examples of

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43. Berg & Karlsson 2000, pp. 93 f, quotation from World Bank 2000a, p. 85.

what can happen in a market economy is easy enough. By that method water or fire can be proved to be bad things, because some people drown and some get burned to death, but this isn't the full picture.

This way one completely ignores the freedom and independence which capitalism confers on people who have never experienced anything but oppression. One also disregards the calm and steady progress which is the basic rule of a society with a market economy. There is nothing wrong with identifying problems and mishaps in a predominantly successful system if one does so with the constructive intent of rectifying or alleviating them. But if at the same time one condemns the system as such, then one begs the question: what political and economic system could manage things better? And what, in history and in the world around us, suggests that it could?

## The East Asian miracle

To gauge the impact of politics on development, it may be enlightening to compare the continents presenting the big contrast in post-war history, namely the growth miracle of East Asia and the disastrous track record of Africa. Zambia in 1964 was nearly twice as wealthy as South Korea. Today South Korea has almost a European standard of living and is roughly 27 times wealthier than Zambia. The Taiwanese used to be about as poor as the population of the Congo. Today they are as rich as the Spaniards, while the Congo has almost marked time. How could things go so well for Asia and so badly for Africa?

The number one success story among developing economies during the post-war era has been East Asia, and especially Southeast Asia. The end of the Second World War found Japan's economy in ruins and the countries it had recently been occupying destitute, starving and wretched. The rest of the world expected these countries to be torn apart by corruption, crime and guerrilla warfare. But since the 1960s these "miracle economies" have had an annual growth rate of between 5 and 7 per cent and their incomes have doubled every decade. Savings, investments and exports have been very large, and the countries have quickly been industrialised. Former colonies like Singapore and Hong Kong have even overtaken the former British colonial power in terms of prosperity.

In nearly all these countries, rapid development has been accompanied by a preservation, or even augmentation, of economic equality. And this despite the absence of a distributive policy. Poverty has rapidly declined. In Indonesia the proportion living in extreme poverty has fallen from 58 to 15 per cent, and in Malaysia from 37 to 5 per

cent. Between 1960 and 1990, average life expectancy in the East Asian countries rose from 56 to 71. In the long term the process also led to the democratisation of countries like Taiwan, South Korea and Thailand – and now Indonesia as well.

These are the states which have proved that it is perfectly possible for developing countries to industrialise and develop. They also showed that this can only happen in a basically capitalist, outgoing economy, not in a secluded command economy. Recently many economists have pointed out that the miracle economies also had a great deal of government control, inferring that they are in fact a counter-argument to the idea of liberalism alone creating development. The first of these statements is correct. In particular the first states in the region to develop – Japan, South Korea and Taiwan – had a great deal of government intervention (the subsequent miracles, Indonesia, Malaysia and Thailand, got their economies moving with a more liberal policy). The state governed investments, regulated the banks, invested in and protected chosen industries, and had a whole battery of possible interventions in its arsenal. But there was nothing unique about this: developing countries in all continents have done the same. The World Bank, in its broad evaluation of the miracles, observes:

*Other economies attempted similar interventions without success, and on average they used them more pervasively.*<sup>44</sup>

The East Asian countries differed from others by committing themselves to establishing and protecting rights of ownership, creating a code for the protection of enterprise and competition, and having a stable monetary policy and low inflation. They went in for universal education, resulting in a skilled population capable of developing the country. Because they concentrated on junior education, leaving

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44. World Bank 1993, p. 6, see also Gunnarsson & Rojas 1997.

higher education to the privately funded market, policy assumed an egalitarian profile, ensuring that higher education establishments were attuned to the needs of the economy.

The East Asian states introduced land reforms which deprived old élites of the land and privileges which they had pirated. This enabled the entire population to participate in the economy. Farmers could now dispose relatively freely of their surplus, saving and investing as they saw fit. This gave them an interest in making agriculture more efficient. The increased yield kept these countries supplied with food while releasing manpower for industry, which in turn encountered rising demand as rural earnings improved. These states have been more interested in creating job opportunities than in stipulating minimum wages and regulating the labour market. This has provided work for most people, and wages have then risen with productivity. Because wages could also be lowered in a recession (at the same time as the goods people buy became cheaper), many of these countries have coped with crises more smoothly and with lower unemployment than others.

In other developing countries enterprise is hamstrung by regulations, and licences and permits are needed in order to start up business. East Asian states, by contrast, have had a notable freedom of enterprise. Individual citizens with ideas have been able to start up firms with a minimum of red tape, and to work untrammelled by detailed controls and price regulations. Hong Kong went furthest. There one could just start a business and then inform the authorities afterwards in order to obtain a permit. This has been hugely important, not only opening the field to initiative but also as an effective antidote to the corruption which often flourishes in the shade of permit procedures.

Although many of the East Asian countries have steered credits and subsidies into the enterprise sector, in doing so they have been less swayed than other developing countries by ties of friendship, the

viewpoints of vested interests or the existence of showcase projects. On the contrary, they have taken a relatively independent line towards vested interests and focused their attention on achievement and the exigencies of the market. Prices in the economy have been far more market driven than in other developing countries. These countries have not had price controls and have not distorted world market prices, and so investments have occurred where they have been most likely to succeed. The aim has been to invest in the sectors where a country is most efficient and has advantages compared with other countries. Many of those in the debate who demand that the government intervene and govern investments feel that it must reduce the tempo, retain old solutions and protect businesses. This is the exact opposite of the Asian governments, who regarded ability to withstand international competition as crucial for businesses. The Japanese government drove big corporations bankrupt because they did not have sufficient profit potential, and South Korea was quite unsentimental about shutting down firms which were unable to produce for an open market. This absence of sentimentality has also been applied to the government itself. Whenever subsidies and expenditure have looked like threatening economic stability, the government has quickly scaled down its commitments, thereby evading budgetary crises and inflation.

Above all, these countries have been fiercely committed to integration with the international economy. They are among the world's most export-oriented economies, and have welcomed huge investments by foreign companies. The bigger trade has bulked in the GDP of countries in this region, the faster their economic growth has been. Most of them have had tariff barriers against imports, but the same goes for the rest of Asia, Africa and South America. The East Asian countries are different in that they applied this policy to a lesser extent than other developing countries and dropped it much earlier. While the others were busily pursuing self-sufficiency and avoiding trade,

the East Asian countries committed themselves to internalisation. In the 1960s they began encouraging exports, partly by abolishing permit requirements and completely exempting exporters and their suppliers from import duties. Tariffs on capital goods have been low. According to the index of openness constructed by Harvard economists Jeffrey Sachs and Andrew Warner, these countries were among the first developing countries to open up their economies by reducing tariffs, abolishing quotas, freeing exports and making their currencies convertible. The economies of Taiwan, Thailand and Malaysia are rated “open” since 1963 at the latest, Japan’s since 1964, South Korea’s since 1968 and Indonesia’s since 1970. Hong Kong has pursued a more liberal trade policy than any other country in the world.<sup>45</sup> The same revolution did not occur in Latin America until the beginning of the 1990s and has yet to come in Africa.

Far from being an example of the viability of regulation and state control, the East Asian miracle shows that a market-based economy affirming enterprise and openness can create development.

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45. Sachs & Warner 1995, pp. 26–32, 72–95.

## The African morass

The painful contrast to this development is found in Africa, especially south of Sahara. There we find most countries whose per capita GDP has actually decreased since the mid-60s. There we have the world's heaviest concentration of poverty, ill health, undernourishment, illiteracy and child labour. Unlike the rest of the world, over the past 30 years this continent has grown accustomed to a declining standard of living and growing distress. There are certain naturally dictated factors which help to account for this. The tropical climate causes parasitical diseases to flourish, the soil is less fertile and natural disasters are commoner than in our part of the world. One-third of the population live in countries which are completely landlocked, which makes it far more difficult for them to connect with international markets and trade movements. The curious frontier definitions and discriminatory policies of the old colonial powers have contributed towards a severe ethnic and linguistic fragmentation within states. A large part of the continent is being torn apart by wars and conflicts.

But other regions with both nature and culture against them have managed far better than Africa. Even factors like war and famine have political causes – no democracy has ever been afflicted by famine, and no two democracies have ever made war on each other, which shows that to a great extent it is a country's institutions and politics which determine the possibilities of development. In this perspective Africa stands out above all through its far higher degree, compared with other continents, of political oppression, corruption, command economy and protectionism. The African countries have inherited a hierarchic, repressive political structure from the colonial powers, and

have used it to oppress other ethnic groups and the countryside, and for the violation of fundamental rights.

The African leaders have been intent on avoiding the policy of the old colonial powers and also the risk of becoming commercially dependent on them, and so they have tried to build self-sufficient economies with draconian tariffs and with nationalisation and detailed control of industry. The economy has been governed by price and exchange controls, and public expenditure has at times run riot. The urban élites have systematically exploited the countryside. Instead of creating markets, countries established purchasing monopolies which paid wretched prices, and they introduced government distribution of foodstuffs. This way the government confiscated the entire agricultural surplus, thereby impoverishing the farmers and abolishing the traders' occupation. Production fell and farmers were driven into the informal market. This impeded plans for industrialisation and posed a threat to society when the economic downturn set in during the 1970s. After trying to borrow their way out of the crisis, many African states were in free fall by the mid-1980s. Structures collapsed, people starved, there were no medicines and machinery simply stopped when spare parts were missing and batteries went flat and could not be replaced. The fall has stopped since then, but has not yet been followed by an upturn. Between 1990 and 1998 Southern Africa's combined GDP declined by 0.6 per cent.

The cause of Africa's hunger and sufferings is not the desert and drought but political oppressors who have systematically shattered the countries' potential and opportunities for the population.

Instead of becoming "dependent" on trade, these states have become dependent on development aid. Africa south of Sahara has received more development assistance per capita than any other region in the world. Where some states are concerned, the annual development assistance equals twice their own incomes. But instead of going to people in distress, the money has often been used to sus-

tain rogue régimes which have exploited their people. Many western donors declared that these countries were not ripe for democracy and individual rights, and that they should rely on planning the economy and reducing their dependence on trade. The result has not been long coming. Potential business fields have been shattered and whereas in the 1960s Africa had 5 per cent of the world's trade, today it has only 1 per cent.

Africa has been afflicted with long-lived leaders like Mugabe in Zimbabwe, Aarap Moi in Kenya and Mobutu in Zaire who have clung to power with the support of development aid from the western world. Someone has spoken of "vampire states", machineries of state which are not interested in stimulating creativity and growth, only in feathering their own nests with the productive resources of society – in actual fact like an army of occupation. Often the leaders, and the clique surrounding them, have seized property by means of direct expropriation and by massive peculation of government funds. Mobutu is understood to have amassed a fortune of about 4 billion dollars while his country was bleeding to death.

Anyone believing hierarchy to be the same as efficiency should study some of these countries. If anything, chaos prevails within their public authorities. The bureaucracy often ignores routine matters, officials disregard orders from superiors and not infrequently do the opposite of what they are told to. The courts are seldom impartial and do not protect contracts or rights of ownership. Corruption is amazingly widespread, paralysing whole states. Officials demand bribes in order for people to be allowed to work and trade, which makes it hard for businesses and impossible for the poor to do so. Often it is ties of friendship and kinship, not merits, that decide within the administration or the economy. Arbitrary rule and corruption have deterred

enterprises, and many of these countries are receiving no foreign investments at all. Africa has been marginalized – on that point the anti-globalisation movement is perfectly right – but the reason is that the African countries have not participated in globalisation and have instead been subjected to socialism, gangster rule and protectionism. To the peoples of Africa, globalisation has meant little more than their leaders flying off to conferences in other countries.<sup>46</sup>

Some countries in recent years have succeeded in balancing their national budgets, but these are only marginal changes. Challenging strong vested interests, taking vigorous action against corruption, reducing the apparatus of government and opening the economy to competition have proved more difficult. A bare majority of the countries south of Sahara have reasonably democratic régimes, and these countries have the world's least liberal economic systems. Estimating the amount of economic freedom in the region, the Heritage Foundation finds that six countries cannot be measured, owing to war and domestic turbulence. Of the 42 remaining, not one can be classed as economically “free”, only 12 were “mostly free”, 29 were “mostly unfree” and 2 were economically “repressed”.<sup>47</sup>

Zimbabwe is one of the African countries which have gone against the trend of the past decade in favour of globalisation and liberalisation. Under Mugabe the country has closed its frontiers to goods and services from other countries and raised inflation. Recently things have gone completely off the rails, with large-scale expropriation of property, suppression of freedom of expression and acts of terror

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46. Sachs & Warner 1997, pp. 335–376, Goldsmith 1998. A confused interpretation considers Africa *more* integrated than other continents with the world economy, because exports from the African countries are unusually large in proportion to GDP. This, however, is due, not to their being unusually outgoing but simply to the native economy being so extraordinarily weak and small.

47. O'Driscoll Jr, Holmes & Kirkpatrick 2001.

against the opposition. And Zimbabwe's extreme poverty increased during the 90s by nearly ten percentage units – about three million people. Nigeria is another example. This huge country, despite a very big potential of natural resources and agricultural land, has remained abysmally poor because of a very strictly regulated and corrupt economy. On the advice of the IMF, among others, certain structural reforms were inaugurated at the end of the 1980s, but their unpopularity led the Nigerian government to drop them at the beginning of the 1990s. Regulations were reintroduced, the credit and exchange market was abolished and interest rates were controlled. Inflation and unemployment resulted. Between 1992 and 1996 the proportion of the extremely poor rose from 43 to an incredible 66 per cent of the national population. Nigeria today accounts for a quarter of all extreme poverty in Southern Africa. Per capita income today is lower than it was thirty years ago, and health and education standards have fallen.

The economists Jeffrey Sachs and Andrew Warner have studied the growth which different political reforms have brought in various African countries. On the basis of various country studies they have attempted to calculate what growth the continent would have had if it had gone in completely for the East Asian policy of open markets, freedom of enterprise, protection of property rights and a high level of saving. They maintain that, despite its poor natural conditions, Africa would then have been capable of achieving an average per capita growth of about 4.3 per cent annually between 1965 and 1990. That would almost have tripled the population's incomes. Of course, this figure has to be taken with a generous pinch of salt, but however wide the margin of error may be, the figure remains shockingly high compared with Africa's actual growth during the years in question – a mere 0.8 per cent per annum.

Studying the good exceptions in Africa – countries which have gone in for free trade and more open economies – it seems plausible

that a liberal policy could have been so successful. The cattle farmers of Botswana were swift to realise that it was in their interest to campaign for more open markets, and this resulted in large parts of the economy already becoming exposed to competition by the end of the 1970s. Through its association with the EU the country's exports to the Union are exempt from duties and quotas. Since Independence in 1966, Botswana has been the good exception in a continent which has always been dominated by dictatorships. This has helped to make it one of the least corrupt nations in Africa, on a level with European countries. Botswana's economic growth is also reminiscent of that of the East Asian countries, with annual levels of more than 10 per cent between 1970 and 1990. Another state which committed itself to free trade early on is little Mauritius. Through reduced military expenditure, protection of property rights, reduced taxes, a free exchange market and increased competition, the country has achieved growth rates of the order of 5 per cent. Today nearly everyone has access to clean water, and education and health care are expanding. If countries like Mauritius and Botswana can, why should not the rest of Africa be able to? These countries are not distinguished by any difference in human quality. People in other African countries are also inventive and enterprising, but they are forced to use those powers to evade corruption and regulations and to cope with working in the informal sector.

Another interesting African country is Ghana, which liberalised markets and reduced taxes during the 1990s. In particular, agriculture has been deregulated, and tariffs, price controls and subsidies have been abolished. Production has risen fast, which above all has benefited cocoa farmers, but because they have now been able to invest and to afford repairs, goods and services, everyone capable of assisting in these respects has also benefited from the farming boom. Extreme poverty in Ghana fell during the 1990s from 35.7 to 29.4 per cent of the population, and the country recently introduced a democratic

power transfer. Uganda has developed on similar lines and is one of the countries which have been liberalised fastest in the past decade. Trade there has been quickly liberated, price controls abolished, taxes lowered and inflation reduced, at the same time as the first steps have been taken towards protecting property rights and deregulating financial markets. This, coupled with extensive development assistance, has given an annual growth of more than 5 per cent, at the same time as inequality has diminished. In only six years, extreme poverty in Uganda fell from 55.6 to 44 per cent. A relatively high degree of openness and the information work of independent organisations have made this the first country in Africa where the spread of HIV/AIDS in the towns and cities has begun to diminish.

Examples like these of African “lion economies” (the counterpart of Asian tigers and dragons) have shown, despite setbacks, that poverty is not a dictate of nature. Slowly, very slowly, certain states south of Sahara are beginning to use their resources more efficiently and to give their citizens greater economic liberties. The democracies are growing in number and urbanisation is breaking up old tribal loyalties which have hitherto stood in the way of equality before the law. Competition is reducing corruption, because rulers no longer have the same power to confer and withhold permits and privileges. Interest in foreign investments is another motive force, because companies shun investment in corrupt economies. The controlled economies are becoming a little frayed at the edges. The proportion of national budgets south of the Sahara devoted to health and medical care increased, albeit marginally, during the 90s.

Africa has an incredibly long way to go, but, contrary to what some maintain, it can be done. From being in free fall, many African countries have been stabilised, albeit at an extremely low level. It will take determined democratic and liberal reforms to move things forward, and the implementation of those reforms will require democratic leaders with the courage to put the people’s interests before those of their

friends and the bureaucracies. Given the grim starting point, it is unlikely, but not impossible, for the 21st century to be Africa's century.