

Preface: Economic Freedom behind the Scenes

By Milton Friedman

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The meeting of the Economic Freedom of the World network late in 2001 in San Francisco re-united the two prime movers of the Economic Freedom project: Milton Friedman and Michael Walker. The meeting, chaired by Dr. Walker, offered network members from around the world the opportunity to put their questions about the economic freedom project directly to Rose and Milton Friedman. What follows is an edited excerpt from the discussion.

Milton Friedman: I am enormously impressed by the cooperation that has been achieved among so many countries in the economic freedom project and by the diligence with which Jim Gwartney and Bob Lawson have managed to put the statistics together into this impressive array of findings [the series, Economic Freedom of the World].

In looking to the future, I believe one has to be careful not to over-emphasize the role of economic freedom as a source of economic growth, as compared with the role of economic freedom as a part of freedom, of human freedom.

We've talked about economic and political freedom as if they were wholly separate things, which they are not. I think the next big task facing the economic freedom project will be to try to weld the two together and make a combined index of economic and political freedom, especially where they mesh with one another. Property rights are not only a source of economic freedom. They are also a source of political freedom. That's what really got us interested in economic freedom in the first place. Some of the elements in the Freedom House index seem to me to be inconsistent with some of the elements in our index, and it would seem to be useful to see how to reconcile those two and put them on the same philosophical basis.

Question: Various concepts of freedom are in play. Could you give us your thoughts?

MF: I've grown increasingly to think that we need to make three classifications instead of two: economic freedom; social or civil freedom; and political freedom. Hong Kong is the key example of the importance of that distinction. Hong Kong has never had any political freedom as Freedom House would understand it. More recently, it has had a little but, as long as the British were in control, it was essentially a benevolent dictatorship. It was run by officials in the British foreign office and, yet, Hong Kong had a very high degree of civil freedom-freedom of speech and freedom of association. You can have a high degree of social freedom, and a high degree of economic freedom without any political freedom. What's not clear is whether you can have any political freedom if you don't have some of the other freedoms.

Q: Those inter-relationships relate, in part, to the importance of rule of law and, indeed, to the even-handedness of the legal system in general. If we reflect upon the fall of communism and the transition from the centrally planned economy to a market economy, what have we learned in the last decade of the importance of economic freedom and other institutions that may be necessary to support economic freedom?

MF: We have learned about the importance of private property and the rule of law as a basis for economic freedom. Just after the Berlin Wall fell and the Soviet Union collapsed, I used to be asked a lot: "What do these ex-communist states have to do in order to become market economies?" And I used

to say: "You can describe that in three words: privatize, privatize, privatize." But, I was wrong. That wasn't enough. The example of Russia shows that. Russia privatized but in a way that created private monopolies-private centralized economic controls that replaced government's centralized controls. It turns out that the rule of law is probably more basic than privatization. Privatization is meaningless if you don't have the rule of law. What does it mean to privatize if you do not have security of property, if you can't use your property as you want to?

We boast in the United States that our nation is a bastion of private enterprise but, in fact, what we can do with our private property is severely limited. To begin with, the government takes a significant proportion, at times as much as nearly 40 percent of it for its purposes and, in that respect, we're a nearly 40-percent enslaved state.

The road from a centralized government to a truly free, private-enterprise society has three components. First of all, and most important, the rule of law, which extends to the protection of property. Second, widespread private ownership of the means of production. Third, freedom to enter or to leave industries, freedom of competition, freedom of trade. Those are essentially the basic requirements.

We've got a very interesting experiment under way. All of a sudden, countries are moving from centralized control in an attempt to achieve a market economy. We've had in the past 10 years a wonderful body of data with which to try to analyze what are the essential requirements for success in that venture. The mere elimination of communism does not convert a nation to freedom.

Q: Intellectual property rights are under attack. Could you dwell a little on that?

MF: The question of intellectual property rights is very complicated. Freedom of speech is the opposite of copyright, which means that you can't get copyright rights. And, intellectual property is different from physical property: in both cases, you have a monopoly but the monopoly on intellectual property is wholly different because duplicating the property comes generally at a very low or zero marginal cost. You are enforcing a monopoly pricing, as it were, that limits output to lower than the optimum social level. You cannot be in favor of infinite copyright. Essentially it's a problem of practical compromise, whether you have 17 years, 25 years, 10 years, 50 years.

Q: I don't understand your distinction between political freedom and social freedom.

MF: I was thinking of political freedom as essentially the mode of representation in the political structure, the right to vote, the definition of democracy as the society in which the public servants-the people who determine public policy-are chosen by the votes of the citizens. That's political freedom. That's the kind of freedom that Hong Kong does not have. By civil freedom, I mean the freedom to speak, the freedom to assemble, the freedom to express your views-what we call human rights. It seems to me that they are quite obviously different. The most important difference is that you can have economic freedom and civil freedom without political freedom but it seems to me very dubious whether you can have any kind of effective political freedom without having economic freedom, without having some independent source of power as opposed to the vested authority.

Q: How do we measure the "rule of law"? I do not believe that it is just procedures. What really matters is the anchoring in social behavior, honesty, customs, and so on. In China, the formal aspects of the rule of law are pretty atrocious. But, if you work in China, as I frequently have, you realize that there are certain fundamentals dating back maybe 2,000 years, which underpin the rule of law in a much more informal way. You don't lie to neighbors, for instance. You may lie to the state in China or to outsiders but you are honest and loyal to people within your neighborhood. And, I would like to ask you how we

could promote these informal rules and how important they are as a foundation for society, as opposed to the formal procedural protections of the rule of law.

MF: I really don't know how to answer that. That's not a subject I can pretend to have done a great deal of work on, but it's clear that what's written down on paper is not what matters. What matters is what happens in practice. Many of the Latin American countries copied word for word the American constitution but these constitutions did not have the same effect in those countries as here. Forms alone are not enough. It's not an easy topic. It's one of those things where "you know it when you see it," even if you can't define it. You can have two countries that seem to have, on the books, the same law yet the actual results are very different.

Q: The point that was made about economic freedom, civic freedom, and political freedom, has become very, very important, and connected to the issue of the rule of law. I teach a class for the international affairs department at Princeton and this fall our class ended in a stalemate. Which is the best route to reform-political reform as in Russia or economic reform as in China?

MF: Comparing those two measures, it looks as if China has done better but it's very hard to make any long-run predictions because China's system is very unstable. On the whole, it's not desirable to have to depend on a benevolent dictatorship. Most dictatorships aren't benevolent and those that are generally won't last. When you have a transition from one dictatorship to another, it doesn't stay benevolent.

Q: I wonder if we are not coming upon a hard paradox in these three relationships. Consider a country suffering from an absence of political freedom but with economic freedom and certain civil liberties that allow the economic freedoms to flourish. Acquiring political freedom becomes a problem because the government sees that maintaining economic freedom is more important than certain political freedoms.

MF: I don't think the situation can be described as you have described it. In my opinion, the expansion of economic freedom will bring in train greater political freedoms. If you look at what's happening in China, that seems clearly the situation there. You haven't had what Freedom House would call political freedom at the higher levels of government but you are already getting it as some of the lower levels. In the villages and the small towns, you are having more and more elections, more and more movement toward political freedom in that sense. So, I don't believe the situation is one in which you sacrifice economic freedom for political freedom. I think it's more the other way around. The more you can advance economic freedom, the more support there will be, the more pressure there will be, for a considerable degree of political freedom.

Q: Do you think that over the years something has changed in our concept of economic freedom?

MF: I don't think the concept of economic freedom is any different. But, I think our understanding of the interrelationships between economic freedom, and civil and political freedom, is more sophisticated than it was. When *Capitalism and Freedom* was published in 1962, it was straightforward: political freedom versus economic freedom. It was only really the experience of countries like Hong Kong and Singapore that led me to believe that we really ought to have a tripartite distinction, rather than a two-way distinction. But then, the real world is a complicated world. There's a phrase written on the entrance to one of the social sciences buildings at the University of Chicago: "When you cannot measure something, your knowledge is meager and unsatisfying." In the process of measuring, you find that measuring is a form of definition. It isn't just that there's economic freedom out there to be measured. In the process of measuring it, we're going to define what economic freedom is. We don't really know what we have, what economic freedom is, unless we've gotten to the point of trying to measure it and see what variables it consists of, and what each of those means. Over the course of time,

we have gotten a much more sophisticated understanding of what we mean when we talk about economic freedom.

Q: It's one thing to be concerned and preoccupied with emerging nations and their efforts to acquire freedom and the rule of law. Of equal concern to me is what's happening in mature nations, where the rule of law is being supplemented by the rule of the regulatory and administrative state. We are losing economic freedoms by virtue of that transformation. My concern is once you acquire the rule of law, retaining it in any meaningful way is tough.

MF: There is no doubt that that is right. There's a strong force always for government to expand. Everybody is in favor, and talks about being in favor, of free markets and private enterprise. But that's talk. If you look at what's happening, in most countries of the world-or in many of them anyway-the size of government is growing, not getting smaller. Here in the United States, we've been through a fortunate period in which we had divided government. As a result, we did not get many new laws. The economy grew and government did not grow, and government went down a little as a fraction of income. But that's a temporary phenomenon. Leviathan government is the basic danger to economic, political, and civil freedom.

Q: Would you agree that there has been some movement towards liberalization, in, for example, international exchange and financial markets, which also promotes liberalization in other areas?

MF: There's been trade liberalization but it's by no means a one-way street. Was the creation of the European common market liberalization of trade? It liberalized internal trade and put greater restrictions on external trade. NAFTA, like all of these trade agreements, has elements of trade diversion as well as of trade creation. World trade has grown more rapidly than world income and that would seem to suggest more international trade. Still, people talk free trade but they don't always support free trade. Mr. Bush is talking about a dumping tax on steel. Absolutely absurd. And it's done in the name of free trade.

I have no doubt that trade liberalizes and that the influence of the West throughout the so-called under-developed world has been promoted much more by Coca Cola than by foreign aid and American embassies. So, I don't have any quarrel with the general proposition but I'm troubled by the extent to which you would describe the movement as a one-way movement towards freer trade.

Michael Walker: I have a question about something we've wrestled with right from the beginning: that is, how can we determine the size of government that is compatible with freedom? We recognize that without some framework of government, freedom cannot exist. On the other hand, government quickly grows to the point where you lose freedom.

MF: I think the optimal size of government is government that controls about 10% of national income. That's much lower than the size of government we now have, and we're headed in the opposite direction. There's no objective way to derive the optimal size of government. I do it on the following basis. Looking back at the period when Britain was ruling the world, at the time of Queen Victoria's jubilee in 1899, government spending in Britain was about 10% of the national income. The church, throughout the centuries, has always favored tithing; that again is 10%. In the United States, before the Great Depression, except in major wars, total government spending (federal, state, and local), never exceeded about 10% of national income. In Hong Kong during its period of real economic freedom, before the Chinese took over, government spending tended to be about 10% to 15% of national income. As a fraction of income, government spending in Hong Kong is tending to creep up, which is going to create real problems.

I also think there is a very real problem in measuring the size of government. The size of government is determined not only by what's recorded as government spending but also by government rules and regulations. In the United States, I would say that half of all spending is controlled by governments at federal, state, and local levels. So we're a long way for that ideal of 10%.

Q: You have been a fellow at the Hoover Institution. My understanding is that when Herbert Hoover started the Hoover Institution, his motivation was deep concern over the relationship between war and totalitarianism. There was the war and the absence of freedom. Do you think that the index would be more instructive if it looked at relationships between economic freedom, or lack thereof, and those societies that are bent on war-making? The growth of government often comes through a series of ratchet effects as a result of national emergencies, real or imagined. And, when these emergencies pass, government remains large.

MF: It certainly is a very important question. War is a friend to government. War leads to an expansion in the role of government. When war ends, government seldom falls back to where it was before. In the United States, government ratcheted up to a slightly higher level through the civil war. World War I did the same thing. World War II did the same thing. We're seeing that phenomenon right now. The talk of war against terrorism has led to a removal of all restrictions on government spending. The budget of the US government is about to explode. We are spending money in foolish and unfoolish ways. The relationship between war and economic freedom is worthy of further investigation.

MW: At the Fraser Institute, we have investigated the relationship between economic freedom and both civil war and external war. We calculated the probability that a nation would engage in war. The results show that, for any given past history of warfare, the more economic freedom a country subsequently adopts, the less likely it is in the future to engage in either internal or external warfare.

In this context, I want to push Milton a little bit on the idea of the optimal size of government. Milton said we should think about the size of government that is most compatible with freedom—that involves the minimum amount of coercion of the citizenry. Yet, warfare is an opportunity for government to get everybody to agree to an expansion of the size of government because they feel threatened.

MF: The optimal size of government does depend on the military situation. The optimal size of government is not the same for Israel as for many other nations. Israel is in trouble in part because its government is too large. Israel has been a very controlled and regulated state, far from a free market. Part of that involved discrimination against Israel's Arab neighbors. Israel would have done far better if it had had a lot freer trade with its Arab neighbors and made fewer attempts to restrict trade. When Israel first won the 1967 war and gained the additional West Bank territory, the government had generals run the territory and they ran it on a strictly laissez-faire basis. They had very little trouble. I remember being over there and being taken around the West Bank by a general. He pointed out that the civil servants were being allowed to accept both Jordanian pay and Israeli pay. They were allowed to use Jordanian money or Israeli money. There was essentially free trade. Everything was working fine. But partly because of internal pressures for restraint of trade, discriminatory regulations were imposed. In a case like Israel, the existence of a specific problem requires a larger government. But their excessively large government has made that problem worse, not better.

MW: Thank you for sharing your insights with us.

Note

(1) Freedom House is an international non-profit organization that rates political and civil liberties across nations.