
GOVERNMENTS CANNOT CHOOSE WHAT IS GOOD FOR US

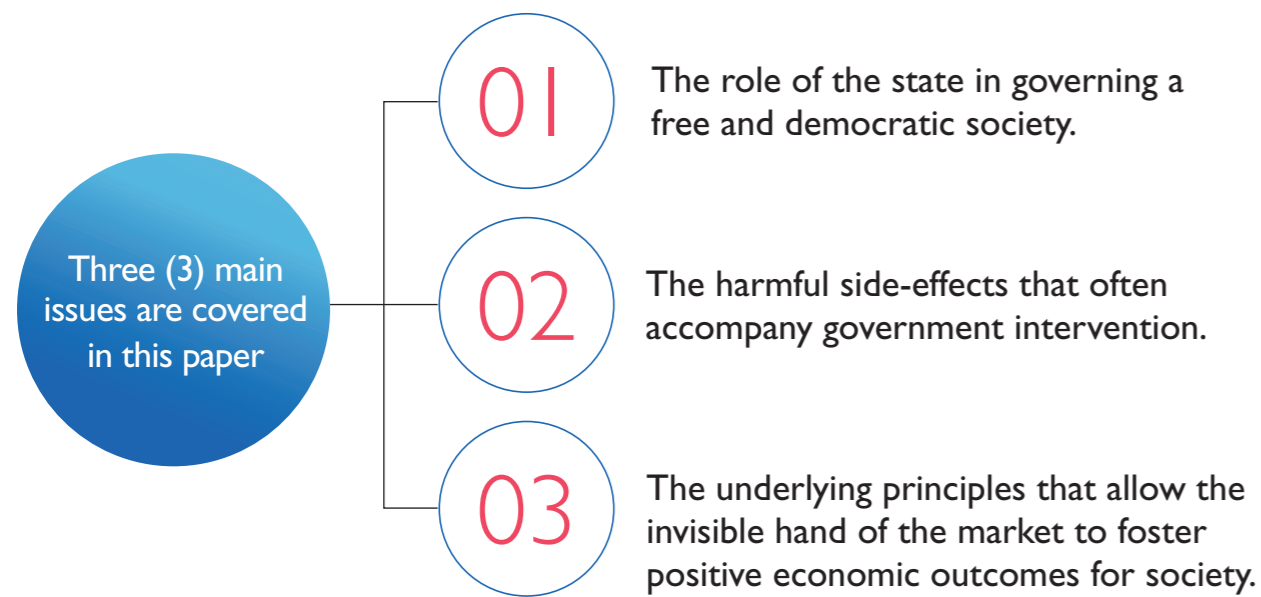
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Executive Summary

This is an edited version of a lecture given on 28 January 2015 at INTI International College, Subang, Malaysia¹. Participants included students and the public. The author, Dr Wolfgang Kasper², is a Professor Emeritus at the University of New South Wales, Australia.



This paper also provides a brief summary of the leading economic thinkers, as well as the ideas and theories that they developed and espoused. It also shines some light on the imperfect nature of collective action and decision making, which forms the basis of government action and intervention in markets. These imperfections in turn lead to injurious outcomes like corruption, cronyism and other rent-seeking activities, which are typical in most developing countries.

Also addressed is the issue of market failures and the mechanism by which unfettered markets spur continuous competition and innovation to the benefit of consumers. The paper ends with a comparison of private vs public choice and a list of policy recommendations for developing countries to adopt, in order to climb up the rungs of the economic ladder.

¹ This is an edited version of a lecture on 28 January 2015 to students and the public at INTI International College Subang, Malaysia, under the auspices of IDEAS, the Malaysian free market think tank.

² Professor Emeritus, University of New South Wales, Australia. I thank the three discussants of my lecture, Dr Teo Leong, Dr Carmelo Ferlito, and Dr Daniel Schoch, as well as colleagues of the staff of INTI College, and members of the audience for their comments, which have helped me to prepare a better written version of my presentation.

Introduction

Having served as the Economic Advisor to the Malaysian Treasury some forty years ago, I am always pleased to come back and observe the astounding material progress and social change in this country.

“
Government has been and will always be there.
”



Wolfgang Kasper is Professor Emeritus at the University of New South Wales, Australia. Kasper has written and lectured widely on the role of institutions in economic development and has authored some 20 monographs and over 200 articles. Kasper is an elected member of the Mont Pèlerin Society and serves on the Academic Advisory Council of the Centre for Independent Studies in Sydney.

It is often said that he who invents the perfect mousetrap will be rewarded with great fame and fortune. Yet, the mice and rats are all too often still getting away. The same can be said of devices to ensure good government – government for the prosperity and peace of all citizens: The kleptocrats and rent-seekers are all too often getting away! I say this to foreshadow that I cannot offer you the ‘perfect mousetrap to catch the enemies of good government’. All I propose to do is to list a number of commonly occurring problems that arise with collective, political choices by government and, by doing this, outline a few basic ideas of the important discipline of public choice economics.

The first point to make is that the government has been and will always be there. The nice intellectual games, by which radical libertarians discuss how everything can be solved exclusively by private choices that are coordinated in markets, are in reality an escapist diversion from the thorny core task of political science and political economy, namely to discuss the size, functions and structures of government. I am a classical liberal, and classical liberals are not anarchists.

The Functions of Modern Government

What are the functions of modern government? We can draw on the insights of philosophers, such as John Locke, the Baron de Montesquieu, Adam Smith and the Scottish Enlightenment, and, of course, the fathers of public choice economics, James Buchanan and Gordon Tullock.³

Function

01

The first function of government is to protect the citizens from external aggression and internal coercers and fraudsters.

The protective function requires that a government relies ultimately on a monopoly of using violence. To this end, they have to employ 'violence professionals', such as the military, the police, judges, and jailers."

Function

02

The second function of government is to be productive:

There are certain goods and services, which are important to the citizens' well-being, but which no individual would supply. An example is street lights. One cannot collect a fee from every passer-by, because each citizen's use does not impede the use of others (non-rivalrous demand) and because once the street light has been erected, it would be difficult to exclude its benefit to those who did not pay for it (non-excludable).

Function

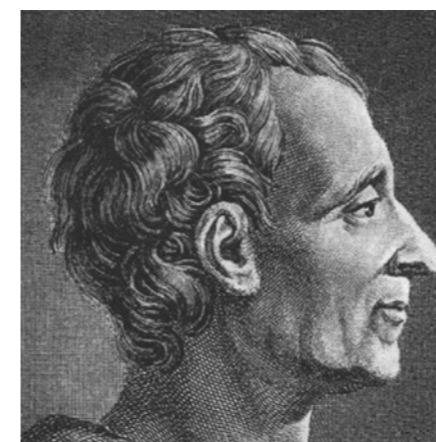
03

The third function of government has been distributive.

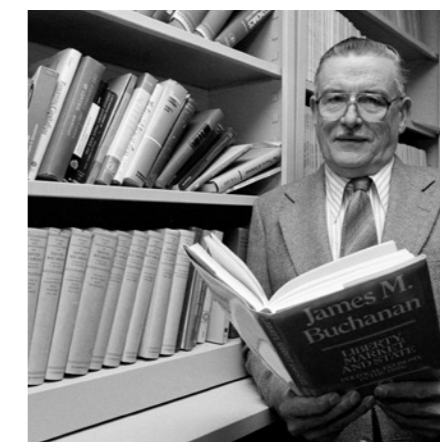
In any society, there are maybe five or seven percent of the population who, cannot fend for themselves, and should be materially supported by government on humanitarian grounds. Traditionally, it was said that the task of the king was to assist the 'waifs and widows' by raising taxes and subsidise them. The redistributive function has become extremely problematic in modern electoral democracies. It has become the growth industry of the 20th century and has created huge, unexpected and damaging side effects.

³ A recommendation for students: look up the short biographic sketches of the leading thinkers, who are mentioned here and depicted throughout the text, in the excellent Concise Encyclopaedia of Economics (D.R. Henderson, 2008).

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The modern concept of government is secular and is focused on the interests of free citizens
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Baron de Montesquieu
(1689-1755)



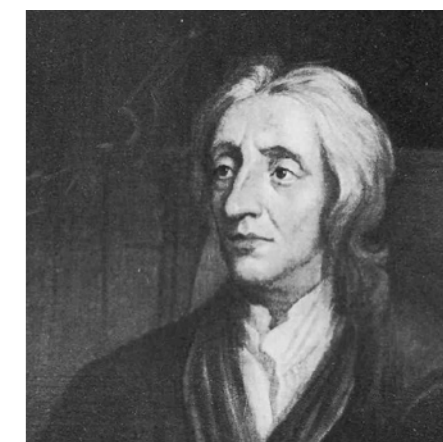
James M. Buchanan
(1919-2013)



Gordon Tullock
(1922-2014)

John Locke's fundamental insight was that **governments are there not for some transcendental reason, but to serve all individual citizens**. These are the principals, and the politicians and bureaucrats are their agents. This concept was first given concrete form in the US Bill of Rights and the US Constitution.⁴ The principle is government of the people, by the people, for the people. It is also the fundamental reason why ordinary individuals from the Third World try to migrate by legal and illegal means into free, citizen-centred democracies.

The concept of the citizen-principal and the mere political and bureaucratic servant of the people is in stark contrast to earlier conceptions, for example the Hindu God King, the rajah, which strongly influenced pre-Islamic thinking about political order in Southeast Asia, the winner-takes-all autocrat, who leads the *umma* in traditional Islam,⁵ or the European Medieval concept of the 'king by the grace of God', who ruled his subjects through a hierarchy of nobility. The modern concept of government is secular and is focused on the interests of free citizens. This important institutional innovation has led to unprecedented, widely spread prosperity of America and Western European states.



John Locke
(1632-1704)

⁴ A few other Western jurisdictions have lived by the notion that government is for the people and by the people, rather than some God-given right, most notably Switzerland, where the people have always been called 'the Sovereign'.

⁵ An Arabic word meaning "nation" or "community". It is distinguished from Sha'b (Arabic: شعب) which means a nation with common ancestry or geography. Thus, it can be said to be a supra-national community with a common history. It is commonly used to mean the collective community of Islamic peoples. In the Quran the *umma* typically refers to a single group that shares common religious beliefs, specifically those that are the objects of a divine plan of salvation.

Principal-Agent Problems and Externalities

The modern understanding of good government by democracy is at least the theoretical idea. However, the practice in all Western democracies often differs from the ideal. The appointed bureaucrats and the elected politicians (agents) are close to the action and better informed than the citizens (principals). This enables them to act in self-seeking, opportunistic ways, while most citizens prefer to remain in 'rational ignorance' about the complicated business of government: **"Why should I bother, I can't change anything!"**

The result is a massive and pervasive principal-agent problem: Politicians behave like traditional rulers with little regard to the interests of the people. We often get government by the bureaucrats, for the bureaucrats! Only citizen engagement, small, rule-bound government, openness and transparent information flows can mitigate that problem.

Only citizen engagement, small, rule-bound government, openness and transparent information flows can mitigate the principle - agent problem.

Another fundamental problem with political, public choices was highlighted by British economist Arthur Pigou. He stated that many private economic choices result in suboptimal outcomes because of externalities – effects of private, bilateral decisions on third parties, which individual private decision makers tend to ignore. For example, the beekeeper has the private, internal benefit of getting the honey, but he also causes an external benefit as his bees pollinate fruit trees that belong to a third party; hence, according to Pigou, beekeepers should be subsidised. Other private economic choices lead to external costs, for example, pollution. When an industry releases toxic waste into the environment, it may impact surrounding

neighbourhoods. To ensure there is no overproduction by such an industry, Pigou argues that it should be taxed. The contemporary Pigouvian mega tax is pushed by the United Nations because the use of fossil fuel supposedly affects the global climate. The UN and many tax-hungry governments say all such energy uses should be taxed: air conditioning, car travel, transporting food from one continent to another etc. All these sinful activities should be burdened by taxes that go to the UN and greedy governments! In my opinion, the 'Saving the Planet' campaign is the racket of the century! It is based on poor economics. To explain this, I need to divert into an important methodological aside.



Arthur C. Pigou
(1877-1959)

We often get government by the bureaucrats, for the bureaucrats!

An important methodological aside

Every introductory economics textbook begins by saying that economics is about scarcity, i.e. the fact that, most of the time, human wants exceed the material resources to satisfy them. After that point, many textbooks talk about known resources and given wants, often represented by indifference curves. It is assumed that we have 'perfect knowledge' about all that. Economics then becomes a matter of maximizing satisfaction with given resources, a mere calculus game. This conception is inspired by the notion of a household (Greek Oikos, hence economics).

Imagine this scenario; it's the beginning of winter and there is a store of food, and the benevolent patriarch, who knows the needs and preferences of the family perfectly, allocates the food. He rations scarcity so that all get over the winter.

This conception goes back to English economists such as Alfred Marshall (1842-1924), who founded neoclassical economics, and John Maynard Keynes (1883-1946), who developed macroeconomics on the basis of these assumptions. These assumptions allow the creation of precise, easy-to-teach models and the application of econometrics. It leads to copious interventions by a well-meaning, fully informed government (a kind of patriarch).

But there are other textbooks, which look at scarcity in much more realistic, dynamic, evolutionary terms. Economic life is in reality a game of different actors, who cooperate to produce goods and services, which no single person would ever be able to produce on their own. Even as simple a product as a pencil depends in reality on the voluntary cooperation of many people with specialist skills, tools, and knowledge, people who do not know or love each other (Read, 1958). They are

all partially ignorant, but consistently and continuously discover new resources and wants. **Producers compete with each other ceaselessly to find new, useful knowledge, and consumers come up all the time with new wants.** Both test new knowledge in markets. The bits of new knowledge that are useful, and hence profitable to producers, are adopted and those that are not are abandoned. This complex evolutionary process of interaction is the essence of economic development (Hayek, 1978). It drives the discovery and cooperation, for which the old Greeks had the word 'katalatein'. Think of a merchant sailor arriving in a new port, asking around, finding useful commercial information, interacting with strangers and turning them into friends.

This perception of economics goes back to the likes of Adam Smith, Carl Menger, Ludwig von Mises and Friedrich A. Hayek. Since the latter three began their teaching careers in Vienna, Austria, we call this open-ended, evolutionary type of thinking about economics 'the Austrian School'. It focuses on enterprise, innovation, and the 5 conditions for development, in particular the rules of interaction, which we call 'institutions' (Kasper, Streit, Boettke, 2012, pp. 31-38).

Another central feature of Austrian economics is that it considers diversity and decentralisation of decision-making as benefits. After all, no one can know everything. The reality of many specialists interacting with each other differs from the assumed know-all patriarch of neoclassical tradition. Knowledge is so complex and rich that it cannot be concentrated in any one mind. Moreover, diversity applies to peoples' changing, subjective wants. Our opportunity costs differ, just as our subjective tastes and preferences differ. For example, your opportunity cost of reading this may be that you cannot go

jogging; your friend's opportunity cost would be that she cannot go to a beauty parlour.

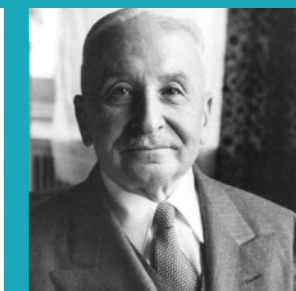
Those who are interested in economic development, successful business, and a free society should depart from the know-it-all and unrealistic neoclassical economics. Ask yourself, 'what is more realistic?'. The assumption that someone knows everything or that we are all seeking, in our own diverse ways, more knowledge to better our condition? Of course, we would like people in authority to be benevolent and all-knowing, but aren't they often forgetful, opportunistic, selfish and ignorant, as Austrian economists correctly

assume? Can business executives assume – as neoclassical economics suggests – that all else will remain the same (ceteris paribus)?

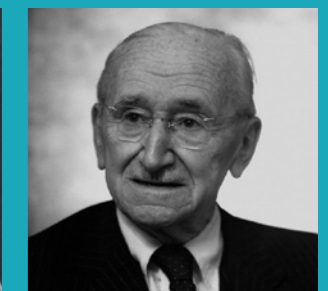
It is no coincidence that Austrian economics now thrives in developing countries and is popular in business schools, while simplistic, unrealistic neoclassical economics still dominates academic ivory towers. (see Bauer, 2000; also Kasper, Streit, Boettke, 2013, especially the Epilogue: 'Institutional versus neoclassical economics', pp. 525-535)



Adam Smith
(1723-1790)



Ludwig von Mises
(1881-1973)



Friedrich Hayek
(1889-1992)

Market Failures Derive from Utopian Neoclassical Economics



Ronald Coase
(1910 - 2013)



Harold Demsetz
(1930 - Present)

One of the examples that Arthur Pigou had used to argue for more government intervention was that lighthouses around the coast of England needed to be provided and run by government, since fees for their upkeep could not be collected from passing ships, although these enjoyed the external benefit of enhanced safety. Along came a young economist, Ronald Coase, who knew that lighthouses had been built and financed by voluntary merchant associations and mariners. He showed that many - not all - of Pigou's externalities could be handled more efficiently by mutual, cooperative private agreements. Pigouvian, neoclassical analyses were thus often unnecessary. There was too much government meddling. Alleged market failures only led to a proliferation of administrative failures.

In his footsteps came Harold Demsetz, who showed that in most cases the government has no legitimate productive function. The role of government is to give everyone access to certain goods and services, but these should be supplied by competing private producers, who are exposed to competitive discipline. A big problem with traditional public-sector production has been that it is run by inefficient government monopolies and administered by risk-averse, unionised, self-seeking bureaucrats (the principal-agent problem writ large!).

We now have numerous experiments and successes with reforms that have been inspired by the Coase-Demsetz

insights. In many jurisdictions, there are now government and private schools, all of which have to compete for tax-funded education vouchers. **Malaysians who are concerned with the quality and content of their public education system should study the experience of Sweden.** Politicians and the teachers' union used to dominate Sweden's education system; it produced poor outcomes, measured by PISA studies. Now, it has been reformed with good success. Sweden has risen greatly in educational attainment. One should also take a good look at trust hospitals, government vouchers for health treatment and private health insurance, and competitive solutions that have replaced the inefficient production of public housing in a number of countries. Good governance can be greatly advanced by these modern ideas and this is an exciting area of practical policy reform and for imaginative research!

Sometimes it makes sense to keep a network in public ownership, but privatise related users. Thus, private and competing train services may run on public rail networks, just as private buses use state-owned or privately owned motorways. If a country privatises rail services, as Britain did, it has to ensure that rail bureaucrats and unions do not undermine the changing business culture — a point that was badly neglected in the case of British Rail. It must also allow for changeover costs since all cultural change takes time and requires learning, particularly by those

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A big problem with traditional public-sector production has been that it is run by inefficient government monopolies and administered by risk-averse, unionised, self-seeking bureaucrats (the principal-agent problem writ large!)
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who lose their rents as well as previously featherbedded socio-economic positions.

One also has to accept sometimes those private monopolies and rents that pioneering innovators reap are temporary and self-correcting. Monopolies do not last if governments do not protect them (Friedman, 1962). Even a private rail net monopoly faces competition: from air and bus travel, as well as road and ship transport. Let competition rip!

Private-public partnerships (PPP) are often discussed in this context and tried out in practical politics. There is a place for them, for example, in financing and building new infrastructure projects. If one ever negotiates a PPP, be wary that the costs are not socialised while all gains are privatised!

The effectiveness of modern governments can be greatly improved by rethinking the productive function on the basis of Coase-Demsetz inspired principles. One cannot be prescriptive and general about solutions. Each case differs and requires careful analysis of the long-term costs and benefits.

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Monopolies do not last if governments do not protect them
(Friedman, 1962)
”

Socialised Property

Is there any reason that justifies public ownership of the means of production? The only legitimate reason for socialised capital is the control of violence professionals, who are the ultimate enforcers of the rules, which protect our lives, limbs, property, and liberty — the military, the police, the judges, and the jailers. Controlling them is an important challenge for governments. If the judges are corrupt and an independent judiciary that begins to go against the interests of the citizenry cannot be controlled, we get bad government. When private judges compete for clientele, decisions are made in favour of the highest briber, and the law becomes corrupt. If the military is not controlled by the purse strings, the country may get military rule and woeful outcomes. The 'collateral damage' when mercenary armies compete has nothing to commend itself, take for example, the China of one-hundred years ago or present-day Africa. When the police are not controlled by the allocation of finance, we get police states and a poor quality of life.

Some of the protective function can, of course, be left to private enterprise, for example, to your *jaga*⁶ or private arbitrators. However, a decent society needs the ultimate public backstop of financially controlled violence professionals.

The Harmful Side Effects of Redistribution

As already noted, redistribution by the visible hand of government has been the growth industry par excellence in the democracies during the 20th century, mostly in the mature industrial countries, but also in Malaysia. Organised groups demand political preferences, as compared to the income distribution that results from private choices, which are rewarded in the market, as if by an invisible hand. Politicians oblige by taxing the general public to subsidize the well-organised and well-connected, or by giving them protection from competition (tariff protection, licenses). Such interventions may secure re-election, political party donations and might further their career and maybe guarantee them a lucrative advisory position after retirement.

This collusion is called rent-seeking. It normally comes with numerous deleterious and often cumulative side effects that no one expects. If you analyse policy with neoclassical models, which assume *ceteris paribus* (all else remaining the same), you are of course blind to these harmful side effects, which is, by the way, one reason why neoclassical models are so popular with advisors to interventionist politicians and bureaucrats.

⁶ A Malay word meaning security guard or gatekeeper. The use of the word is more to a colloquial context in the Malaysian society.

The Harmful Side Effects of Redistribution (*continued*)

Let me enumerate some of the problems that tend to occur when redistribution by ignorant and self-seeking public-choice makers become dominant, for example, in the Western welfare states and in Malaysia in the wake of the New Economic Policy (NEP):

- Redistribution has not been very successful in eradicating poverty. This is so because the recipients of government handouts develop a claims and dependency mentality. **They learn helplessness.** Why make an effort to study, work, save, and invest when you get social welfare or protected jobs?⁷
- Being a welfare recipient breeds boredom and discontent. **Young men, who are featherbedded by the government, lose their self-respect and often seek distraction in violence and drugs** — or, worse, join

ISIL in Syria for a challenge and the chance to prove themselves.

• The burden of welfare redistribution leads to budget deficits or higher taxes, which are disincentives for the producers and investors. **When the tax costs are high, countries lose competitiveness.** Look at the backslide of Old Europe to see how redistribution destroys work effort, enterprise and international competitiveness! Internationally, mobile capital and enterprise migrate elsewhere. Unemployment then becomes entrenched,

and growing government debts become a massive burden on future generations.

- Economic life becomes politicised and confrontational. Producers become lobbyists and neglect efforts to enhance production and create jobs. **As a result, tensions increase within society, which is bad for stability and internal peace.** Politicians, bureaucrats, as well as business leaders become corrupt (*Kasper, 2006*).
- The coordination of private choices by price signals in free markets is increasingly distorted by redistributive taxes and subsidies. **Markets become dysfunctional** (*Friedman 1962*).

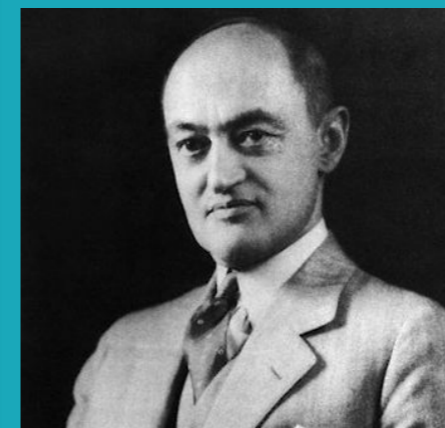
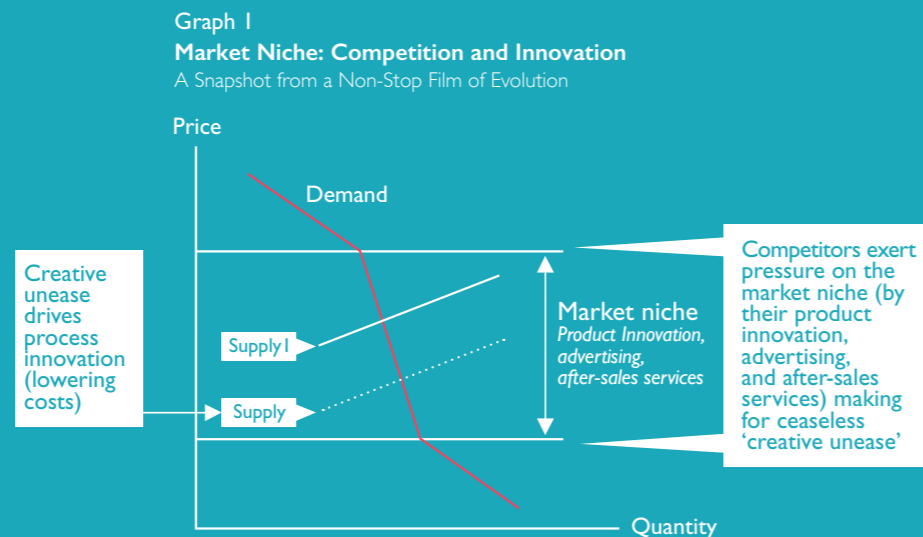
A Second Methodological Aside: Competition and Innovation

Economic progress results from competition. Suppliers rival with each other to position themselves so that they are attractive to potential buyers and buyers rival with each other to gain better knowledge (think how much time and effort intending home buyers invest in knowledge search before they make a bid for a property). This rivalry by knowledge search has driven modern capitalist civilization to unprecedented heights.

Benz built, to the modern limousines that we now drive. Our car producer also sings her own praise by advertising, thus saving the demand side of the market information costs, and by offering after-sales services - all to create inelastic demand, in other words a market niche. The trouble for her is that her rivals compete with the same instruments to crowd in and narrow her market niche. She can never rest on her laurels; she is kept in

'creative unease', as the Austrian-American economist Joseph Schumpeter called it. This obliges her to search knowledge to cut costs further (downward shift in the supply curve in Graph 1), which adds up to ceaseless process innovation.

To illustrate this a little better, let us take a momentary snapshot from an endless film of market competition: Graph 1 may reflect the situation of a car producer. She has a rough understanding of a downward-sloping demand curve for her cars. If she raises the price, fewer potential buyers will be interested. Since she has high fixed costs, she has a great interest in making the demand price inelastic. She tries to create customer preferences for her product by developing new models and through product innovation. This has been a powerful driver of technical progress. In little more than one hundred years, this motivation has led from the rickety jalopy, which Mr. Carl



Joseph Schumpeter
(1888 - 1950)

“
The great achievement of capitalist civilization is not that silk stockings have been put on the legs of the queen, but that all our secretaries can afford cheap nylon stockings.
- Joseph Schumpeter
”

Kasper 2013). Many well-intentioned redistributive initiatives backfire and come with destabilizing, democracy-destroying consequences.⁸

- The essential government function of protecting the private property of the citizens is undermined by redistribution and high taxes. **Governments that confiscate a lot of private income and wealth simply cannot, at the same time, be effective protectors of private property** (*Kasper 1998; 2006*).
- When the visible hand of a government allots **preferential treatments to some, others suffer.** The established and well-connected thrive, but young people without connections are unable to obtain licenses for their modest start-up businesses⁷. They face insurmountable entry costs and become frustrated. Income distribution in redistribution-plagued economies becomes more and more uneven (*de Soto 2001*;

• Then, there is, of course, the redistributive policy of 'welfare for industry', also known as crony capitalism. This leads to high costs, poor quality of goods and services and the eventual slow of economic growth - the much discussed 'middle-income trap' (*Kasper 2013*). To make this clear: I invite you to explore a second methodological aside to basic economics.

⁷ This also applies to Malaysia's New Economic Policy (NEP), which undertook to redistribute incomes, wealth and job opportunities to the Bumiputera by the visible hand of government intervention. The NEP was probably a necessary circuit breaker when introduced in 1970 to overcome entrenched economic differences between the various races. But over time it has arguably hindered the natural multi-generational discovery process, which occurs when less developed groups are confronted with modernity (Sowell, 2012; also Rabushka, 1974): A son or daughter of a Malay kampung dweller does not receive the early-childhood exposure to ideas, motivations and skills that the sons or daughters of urban merchants, doctors or lawyers do. But if Malays move into town and modern commerce, their children have a much better chance to pick up some of these basic attitudes and skills. And their grandchildren if - instead of being mollycoddled - are exposed to open social and economic competition, are likely to perform economically as well as any other Malaysian. The notion that some races are genetically and unalterably less capable of succeeding in a modern mass society, is plain wrong!

⁸ The long-term consequences of visible-hand redistribution for democracy cannot only be studied in the increasingly disaffected European nations, where protest parties are on the rise, but also in the Third World: Redistributive intervention greatly contributed to military government in Fiji and civil wars in Sri Lanka and Burma. In Thailand, the people in long favoured Bangkok and other areas rebelled against the withdrawal of some of their privileges by the Shinawatra administration; when protests (by 'Yellow Shirts') led to a partial reestablishment of their privileges, the countryside protested ('Red Shirts'), which led to military government. By contrast, personal welfare in Taiwan has largely been the responsibility of the citizen and his/her family since the 1950s, as has been the case in South Korea since the abolition of massive political chaebol preferences. Both countries have made it to First World, high-income status.

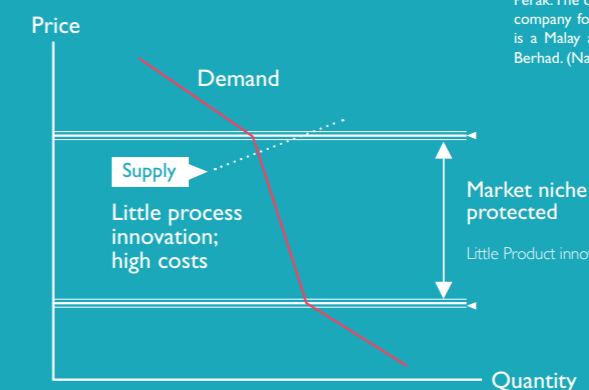
True undistorted competition between private suppliers and buyers thus has driven the enormous material progress of the past 250 years. A triumph of decentralised knowledge search and testing of new resources and wants!

Now, if governments protect preferred cronies from competing, the costly and uncomfortable need to defend the market niche is removed. If governments grant

exclusive licenses to a car producer or protect her from international competition, product and process, it would result in the slowdown of information, costs will remain high, and economic growth slows (Graph 2).

You get cars of lousy quality for twice the world market price. Think only of the pathetic cars that the Indian car industry used to produce, year in and year out, for 30 years, or of the Proton.⁹

Graph 2
Market Niche: Protection and Cronyism
A Snapshot from a Non-Stop Film of Evolution



⁹ Proton Holdings Berhad (stylised PROTON) is a Malaysian automobile manufacturer. It is headquartered in Shah Alam, Selangor and operates an additional manufacturing plant in Tanjung Malim, Perak. The company was established in 1983 as the sole national car company for Malaysia until the advent of Perodua in 1993. Proton is a Malay acronym for Perusahaan Otomobil Nasional Sendirian Berhad. (National Automobile Company Private Limited).

This aside into realistic evolutionary economic theory should go a long way to be convincing that competition is good for economic growth and for spreading its benefits around.

In summary:

The bloating of the redistributive function leads to high cost, poor economic growth, political and social tensions and the unfair exploitation of producers and the young.

Graph 3 is a summary of the key features of economic coordination (ordering) by private and public choices. It should speak for itself. The key advantages of relying on private choice, wherever possible, are that private interaction is based on voluntary decisions, that the costs of coordinating complex processes tend to be much lower, and that private choices and market interaction generate a lot of useful knowledge (catallaxis).

Therefore: privatize, wherever possible

Graph 3
Private versus Public Choice - A Comparison



Private Choice

VS



Public Choice

Exchange	Reciprocal (direct given and take)	Multilateral (direct given and take)
Shirking	Monitored, curbed by insitutions	Common with contribution (tax) Claims (handouts) in excess demand
Motivation	Voluntary	Coercive
Meeting of wants	Diversity, choice	Uniformity; "Mao uniforms for all"
Principal-agent pr.	Self-control by competition	Control by authorities; rent-seeking; rational ignorance
Monitoring, enforcement	Often spontaneous; low cost	Elites are ignorant; high costs
Cost control	Often strong (process innovation)	Normally weak
Knowledge	Markets generate information; catallaxis	Political powers are often ignorant BUT: Political elites and media are influential

Finally, a Few Empirical Points

So far, we have deduced insights derived from a few plausible assumptions about human behaviour and human nature (deductive logic). Are these conclusions true?

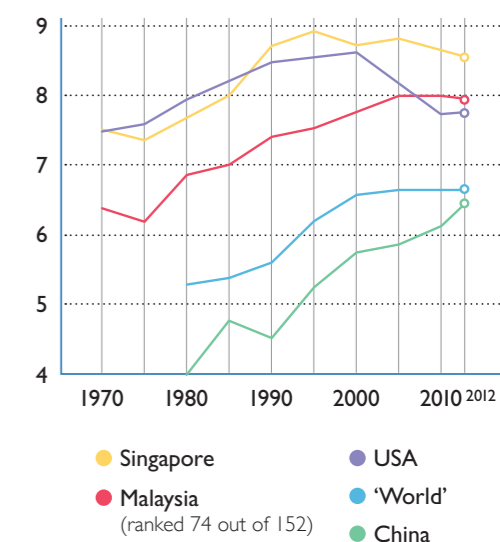
One way to test this is to look at measures of economic freedom, i.e. estimates of how free private competitors are to compete with their labour, skills and physical assets (using inductive logic). Are their property rights well protected, and can they be used freely under the rule of law? **One big international research effort, is led by the Fraser Institute in Vancouver, Canada and the Cato Institute in Washington, DC, USA.** The research estimates economic freedom in over 150 countries. When these freedom ratings are grouped into quartiles, we see that the most free 25% of nations had real per-capita incomes six times (!) that of the quartile of the most least free economies in 2012 (*Gwartney-Lawson 2014 ;and passim*). The most free also had on average consistently higher economic growth than the least free, as well as much higher life expectancies and lower child mortality. The free are getting richer, and the repressed are dropping behind.

“
The free are getting richer,
and the repressed are
dropping behind.”

There is a powerful, uncontroversial policy message for Malaysia in this: If it wants robust economic growth beyond the easily attained middle-income status, it has to develop the institutions that guarantee better economic freedom for all and strengthen the rule of law. (Kasper 1998; 2013)

In Graph 4, we see that there have been substantial improvements in economic freedom in the world as a whole, but that progress has stalled since 2000. It is no coincidence that the world-wide liberal reforms of the 1980s and 1990s were also decades of growing world prosperity, and that the lack of progress in reforms since 2000 is now going along with a lagged slowdown in the growth of productivity and incomes. If we look at how economic freedom in Malaysia from distortive government interference has developed over time, we see that there was a long period of improvements, from 1975 to 2005. This was also a period of good economic growth. More recently, progress has stalled (Graph 4).

Graph 4
Economic Freedom (Protection from Bad Government)
An International Comparison (Index out of 10)



Malaysia now ranks in a mediocre 74th position among the 152 countries analysed. This places it far behind Singapore, and other mature, developed economies, as well as a growing number of reforming developing nations. What also matters for Malaysia is that China has been making fast progress, becoming an increasingly energetic competitor in export markets and for foreign investment (*Kasper 1998*). The relative position of Malaysia on the global scene is not encouraging, though not a disaster like many African countries, Burma and the strife-torn Middle East.

I would also draw your attention to the latest Global Competitiveness Report (*World Economic Forum 2015*), which lists Malaysia as a leader in a group of countries that are trying to move from middle-income to high-income, developed-country status, but that have somehow not yet found the key to that door.

The key is limited, unbiased, rule-bound government.

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