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Economic Development and the Free Market

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Early Marxian view of economic freedom

The idea that the wealth of nations can be expanded most rapidly by governmental direction of their economies is not a traditional socialist concept. In the broad sweep of economic thinking Adam Smith pioneered the view that governmental intervention was a hindrance, not an aid to economic development. He examined what was going on around him in England and some parts of Europe, and he came to the conclusion that if men were given a high degree of freedom to produce, trade and consume, productivity would rise and consumers would be better satisfied.

The socialists, including Karl Marx, did not dispute the contention that economic freedom led to great productivity. They could not, for they had all about them the overwhelming evidence of the industrial revolution which showed that this was true. Note this description of the process of economic development under capitalism by Friedrich Engels.

"...the bourgeoisie shattered the feudal system, and on its ruins established the bourgeois social order, the realm of free competition, freedom of movement, equal rights for commodity owners, and all the other bourgeois glories. The capitalist mode of production could now develop freely. From the time when steam and the new tool-making machinery had begun to transform the former manufacture into large-scale industry, the productive forces evolved under bourgeois direction developed at a pace that was previously unknown and to an unprecedented degree."^{1/}

What bothered the nineteenth century socialists was not the inability of the capitalistic free market to bring about rapid economic development. On the contrary, many of them were appalled by the extent and pace of the economic change caused by the industrial revolution in England. They were all highly critical of what seemed to them to be an unjust distribution of the fruits of production. Marx and Engels shared these views, but they also advanced the idea that this tremendously dynamic productive system would eventually break down because of defects that were inherent in it. They perceived what they thought was a fatal flaw in the constant drive for greater productivity and what they thought was a tendency to minimize the use of labor and the payment of labor. They maintained that this would eventually bring the whole system crashing down and open the way to socialism.

^{1/} Engels, F., "Socialism: Utopian and Scientific," in The Selected Works of Karl Marx, International Publishers, N.Y., Vol. 1, pp. 165-66.

The fact that economic history has failed to bear out these dire predictions of their prophets ought to be a source of profound embarrassment to Marxist theorists. The capitalist states have had their crises, but none of them ever proved fatal, and these economies have not only recovered but have gone on to create and distribute to the workers, as well as to the capitalists and rentiers, wealth on a scale undreamed of in the nineteenth century.

The line changes

The dogma has had to be adjusted to this stubborn refusal of the facts of history to bear out the Marxian hypothesis. We hear less and less about the increasing misery of the exploited workers in the capitalist economies. Even rarer are the predictions of the eventual collapse of the developed economies of the West.

In lieu of this we have a new dogma--one which Marx would never recognize. One might say that just as Marx turned Hegel upside down, so have the modern Marxists turned Marx upside down. Socialism is no longer the synthesis that is supposed to emerge from the inevitable collapse of the most developed capitalist states. Rather, socialism is now presented as the engine of economic development itself. Capitalism, with its bourgeois emphasis upon free trade and free competition, is now portrayed as a system that is useless if not harmful for any underdeveloped country that hopes to see its wealth increase. While Marx and Engels saw in capitalism an irrepressible drive to expand production and productivity which would inevitably bring about its collapse, the modern socialist sees capitalism as completely lacking in dynamism with a fatal tendency toward total stagnation. Socialism is said to be the energizing medicine which the states stagnating under the free market system need to propel themselves into the industrial age. This view has been accepted even by some liberals, one of whom has put this new dogma in these words.

"Only in Russia and China do they (the submerged masses) find a model of how in backward countries great masses of people can raise themselves quickly by their own bootstraps.

"The Communists are expanding in Asia because they are demonstrating a way, at present the only obviously effective way, of raising quickly the power and the standard of living of a backward people."²/

Recent lessons from experience with socialism

The empirical evidence no more supports this new hypothesis than it does the original theory of Marx. While the world has been awed by Soviet space feats, the people of Eastern Europe have grown increasingly critical of the failure of the communist economic system to provide housing, food, clothing and other consumer goods in the desired quantities and qualities. While these countries boast of

²/ Walter Lippmann, Washington Post and Times Herald, November 13, 1958 and December 12, 1958.

Impressive rates of economic growth, their statistics have concealed serious economic failures. This is true not only in agriculture, where the disastrous effects of the communist policies are notorious, but also in industry.

This is why the revolutionary proposal that profit incentives be introduced into the Soviet economic system have made such headway throughout Eastern Europe. This proposal was first made by Professor Y.G. Liberman of the Economic-Engineering Institute of Kharkov in September 1962. Although the Liberman proposals were opposed by communist "conservatives" as being capitalistic, they were introduced in the Soviet Union on an experimental basis in July 1964. More recently, following Khrushchev's overthrow, the Soviet Government announced that it was pleased with the results of the experiment and indicated that it would be extended to other plants. This triggered an announcement by Czechoslovakia that it was completely revamping its economic system to reduce centralized planning and control and place greater reliance on profit incentives and the law of supply and demand. A report from Prague summed up the trouble with the old system in these words:

"Through centralized planning and control, resources were squandered on almost every imaginable industrial product--from airplanes to xylophones. This over-extension produced intolerably high costs of production, manpower shortages and, above all, a loss of quality in comparison with the products of more-specialized competitors. Prague was forced to sell cheaply abroad and the cost of living here soared. There was no way to reverse the trend because central planning of production could control only quantity, not quality. It could not enforce technological improvement, innovation and refinement, which depend upon the producer's interest in his goods."^{3/}

Hungary has introduced "capitalistic" reforms, and Poland is clearly moving in the same direction.

An economic system which has been exposed as suffering from such serious inherent defects in the countries which have tried the hardest to make it work can hardly be recommended as a model to other countries. Where it has been tried in countries even more dependent upon agriculture than those of Eastern Europe, the results have been even more disastrous. Cuba, once one of the most prosperous countries of Latin America, was impoverished by communism in less than five years. China, within a decade of the communist takeover, was shaken to her foundations by the disastrous consequences of the economic follies of the communists. Economic debacles have struck or are threatened in such countries as Indonesia, Burma, Ceylon, Guinea, Mali and Algeria as a result of their adoption of the "socialist" approach to economic growth. Retrogression, not progress, has been the hallmark of communist experimentation in the less developed countries.

^{3/} New York Times, November 6, 1964.

Has the free market economy lost its dynamism?

What of the charge that capitalism is too lacking in dynamism to be useful to developing countries in the modern age? This too is refuted by the evidence.

The striking contrast between the economic restoration of West Germany under free market capitalism and the painfully halting recovery of East Germany under socialism tells a great deal about the relative dynamism of the two systems. Of course, the socialists did not anticipate this result. Paul Hagen, a German socialist, in his book Germany After Hitler, which was published during the war, said that unless Germany adopted a system of "democratic planning, as against a restoration of profit capitalism" the economic outlook for Germany and Europe would be a dark one. He thought that restoring the old system would amount to sentencing millions of Germans to death and would endanger European reconstruction.^{4/} Fortunately for Germany, Ludwig Erhard did not share these dogmatic doubts.

Japan's postwar "miracle"

Japan, like West Germany, has displayed tremendous economic dynamism in the postwar period, while remaining wedded to free enterprise. In 1945, Japan's physical destruction was so complete and the demoralization of her people so thorough, that some observers thought it might take a century for her to recover economically from the war. It actually took less than a decade. Manufacturing output exceeded the prewar level in 1953. Six years later it had doubled and by mid-1964 it had doubled again. Japan is now the third largest producer of steel in the world, ranking behind the U.S. and the U.S.S.R. Japanese consumer goods are not only abundant at home, but they are being sold in great quantities all over the world. Japanese exports, despite discrimination in some markets, more than quadrupled between 1953 and 1963.

It should be noted that this achievement represents a great deal more than merely the recovery from the destruction wreaked by the war. The development of synthetic fibers during the war meant that Japan could not place such heavy reliance on earnings from raw silk exports as she had prewar. Cotton textiles another prewar pillar of Japan's foreign trade also offered diminished prospects, as other countries developed their own mills and restricted imports.

The Japanese knew that they would have to trade to survive, but ten years ago no planner could possibly have predicted the course their trade would take. The Honda motorcycle which has since taken a good part of the world by storm was still little more than a gleam in the eye of a struggling young mechanic. Transistor radios were still unheard of, the world was just beginning to hear that the Japanese could make optical goods that rivalled German goods in quality, and the idea that the Japanese might give the Swiss competition in watches would have been considered a joke.

^{4/} Paul Hagen, Germany After Hitler, Farrar and Rinehart, New York, 1944, pp. 138-48.

Fortunately under the free market system, it was not necessary for any planner to predict or even understand the possibility of these developments. They came about because of the dynamism of the free market system--that same drive for greater efficiency, greater production and greater sales which had so forcefully impressed Karl Marx. The export of these and thousands of other items in tremendous quantities has earned for Japan the means to pay for the huge amounts of food, fuel, raw materials, machinery, equipment and consumer goods that she needs to keep her great industrial machine operating and keep her people well fed and contented. Although Japan has 96 million people crowded into four mountainous islands whose total land area is less than that of Paraguay, they have been able to achieve a reasonably high standard of living. This has been steadily improving in recent years as productivity has gone up. Unemployment is negligible and wage rates are now said to be comparable to those in Southern European countries. The rise in real wages has averaged about 4.5 per cent a year since 1951.

It may be argued that Japan and Germany are exceptional cases, since both had already attained a high degree of industrial development before the Second World War. Recovery and further rapid growth may be easier than starting from scratch--even if it did not so appear to observers at the end of the war.

What about other countries. Are there any which were not already industrialized which have shown signs of development in recent years?

The Hong Kong "miracle"

There has been a striking rise in industrial activity throughout the world in the postwar period, and many of the countries of Asia, Africa and Latin America have participated in this. One of the most interesting examples is that of Hong Kong--both because its growth has been so rapid and because its economic policies have been in such striking contrast to those prescribed by the communists. Hong Kong is perhaps the closest approximation to 19th century laissez-faire capitalism that exists in the world today. In the words of a recent publication of the U.S. Department of Commerce:

"Hong Kong is unique among the world's market's in that it presents virtually no artificial barriers to trade. As a free port, the colony has no protective duties or quantitative restrictions on imports; no difficulties are encountered in obtaining import licenses or foreign exchange; no cumbersome procedures or delays hinder the clearing of merchandise through customs; the Hong Kong dollar is stable and freely convertible....Indeed, the concept of free trade and private enterprise is heartily supported and practiced by all segments of the business and official community and has probably been the single most important factor accounting for the phenomenal development of the colony's commerce and industry over the past decade."^{5/}

^{5/} U.S. Department of Commerce, Hong Kong, A Market for U.S. Products, 1964, p. viii.

Before the war Hong Kong had been little more than a bustling entrepot for China. She resumed this role after the war for a few years, but the communist takeover on the mainland forced a dramatic change in her status. Hong Kong could no longer depend on the entrepot trade for survival. Moreover, her population was being heavily swollen by refugees from the mainland. No planner decreed that Hong Kong should emphasize industry, but it soon became apparent to a large number of people that it might be profitable to start manufacturing enterprises there. Labor was abundant and cheap, taxes were low, red tape was virtually non-existent, raw materials and machinery could be imported freely, and Hong Kong had the whole world for her market.

A start was made in cotton textiles, and by 1957, little Hong Kong was becoming a competitor to be reckoned with in the world's textile markets. The entrepot trade continued, but as early as 1957, about a third of her exports consisted of goods produced in Hong Kong. This ratio grew to three-fourths by 1961.

Hong Kong does not publish an index of industrial production, but some idea of the rate of increase of manufacturing output can be obtained from the statistics on registered factories and employment. In 1950, there were 1,752 such factories employing 92,000 workers. By the end of 1963, there were 8,348 factories employing 354,000 workers. Thus the number of factories had nearly quintupled while factory employment had nearly quadrupled. However, these figures considerably understate industrial employment. According to the 1961 census, 39 per cent of the population was employed, and just over half, or 610,000, was employed in industry.

Hong Kong's industrial development has had to overcome the handicaps of a shortage of land and fresh water. Virtually all raw materials have to be imported, including fuels. This means that industry has not had the advantage of cheap electric power.

Nevertheless a most impressive array of manufactured products is now being produced. Cotton textiles are still the most important single product. At the end of 1963, 632,000 spindles and 19,300 looms were in operation. Over 540 million square yards of cotton cloth were produced, and most of this was exported. Other important industries include plastic products, shipbuilding and shipbreaking, machinery manufacture, cement, aluminum products, clocks and watches, enamelware, electrical equipment and appliances, foodstuffs and beverages, footwear, leather goods, electronic goods, hardware, optical goods and clothing.

A decade ago Hong Kong was hardly anything more than an insignificant spot on the map as far as most people were concerned. Today, she is one of the major trading countries in Asia--and indeed, in the world. In 1963, only four Latin American countries, Argentina, Brazil, Venezuela and Mexico, surpassed Hong Kong in the value of exports. This is a remarkable achievement for 3.6 million people crowded into an area of only 391 square miles which is almost completely devoid of natural resources.

As in the case of Japan, this dynamic economic expansion resulted in higher incomes and improved living standards for the working people of Hong Kong. In spite of the influx of refugees from the "workers' state" on mainland China,

which in 1960 and 1961 helped boost the population of Hong Kong by an incredible 7 per cent a year, labor shortages have developed. Wages, while still low by Western standards, have risen sharply in recent years. Since the increase in the cost of living has been one of the lowest in the world, there has been a substantial increase in real wages.^{6/}

One indication of the improvement in living standards is the sharp drop in the death rate and the infant mortality rate in the last decade. The crude death rate has fallen to 5.5 per thousand, one of the lowest in the world. The infant mortality rate has been cut by 64 per cent since 1948 to the level of 32.9 per 1000 live births in 1963.^{7/} This is considerably lower than the rate for non-whites in the United States, and it compares with rates in Central America and Mexico which range from 80.2 for Mexico to 91.3 for Guatemala (1962 data).^{8/}

The strengths and limitations of economic freedom

Hong Kong's postwar growth is a striking demonstration of just how dynamic a developing free economy can be. It does not prove that every free economy will necessarily be equally dynamic. The colony has had some advantages and some disadvantages not found in other developing countries. Not every country can duplicate Hong Kong's accomplishments even if it pursues identical economic policies. Some countries suffer from even more serious economic handicaps than Hong Kong. Some are so isolated geographically that they are at a serious disadvantage in international trade. Many have a large number of inhabitants who do not easily adapt to new and more efficient modes of production. Others are beset by political instability and strife which discourage saving and investment.

When a country which suffers from serious disadvantages such as these does not make rapid economic progress, the communists invariably place the blame on whatever degree of economic freedom the government may permit.

It would be wrong to pretend that there are always easy, quick solutions to many problems such as these. Economic freedom cannot overcome all such handicaps. Some curtailment of freedom is indispensable to the attainment of a reasonable degree of order and security in society, as Thomas Hobbes long ago convincingly argued in the Leviathan.

It would be equally wrong to argue that all of these problems can be solved by abolishing all individual economic freedom, as the communists propose. This is not merely because freedom is itself something which men prize highly, frequently more highly than material progress. It is because freedom, when properly used, can accelerate material progress enormously. To use an analogy, an excess of lubricating oil may cause a motor to malfunction. This does not mean that you try to operate the equipment without any oil at all. The amount of freedom in an economy, like the lubricating oil in a motor, has to be adjusted to the varying conditions that exist.

6/ Hong Kong Report for the Year 1963, Hong Kong Government Press, 1964, pp. 50-51.

7/ Ibid., p. 453.

8/ U.N. Statistical Yearbook, 1963.

The communists by dogmatically propagandizing against this valuable economic "lubricant," have succeeded in influencing policy in many countries toward minimizing the degree of economic freedom that is permitted. They have systematically labored to magnify the obstacles to economic development in free economies. They have worked to intensify political instability and insecurity, they have done their best to discourage the induction of needed savings from abroad, they have tried to frustrate efforts to increase labor productivity and needed rationalization in the allocation of economic resources. All this has been done to prove that freedom has to be eliminated. The result has been that many economies are functioning at far less than the highest possible level of efficiency either because they have permitted too much liberty to those whose main objective has been to keep the economy from performing satisfactorily, or because they have given in to unreasonable pressure to restrict freedom which might improve the functioning of the economic machine.

The experience of Japan and Hong Kong, where these machinations have had no success, deserves careful study and emulation by the countries of the world which wish to develop economically.