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Economic Freedom and the Advantages of Backwardness

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According to econometric studies, economic freedom and its improvement increase growth rates.¹ But their effects are dominated by the effects of the level of economic development and human capital. Do these findings imply that defenders of capitalism and economic freedom exaggerate their case? Not at all.

Consider the level of economic development that determines the *potential* advantages of backwardness. Economists usually discuss the reasons for the existence of these potential advantages: less developed economies can borrow technologies, business models, and marketing procedures from more advanced economies;² and imitation may be easier and faster than innovation on which the leading economies have to rely.

Plausibly, these advantages are greater at moderate levels of backwardness where the level of human capital formation permits the exploitation of the opportunities of backwardness. Or, less developed economies have more scope for reallocating labor from less productive work in agriculture to more productive work in industry or services. Or, it is probably easier to find profitable investments in developing countries—say, in transport infrastructure—than in highly developed economies where many of the obvious investments have already been made. I do not want to join the debate about the relative merit of these arguments. Nor do I want to add arguments from other social sciences according to which the process of economic development implies value changes that feed back to undermine prospects for later economic growth.³

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The Role of Advanced Countries

Instead, I want to underline the obvious, which nevertheless tends to be forgotten: the advantages of backwardness for some developing countries presuppose the existence of advanced countries. If advanced countries—say, the United States, European nations, and Japan—had not existed, the early East Asian tigers (South Korea, Taiwan, Hong Kong, and Singapore) could never have grown as fast as they did, nor could China and India do so today. Before the mid-20th century and its previously unknown income differentials between Western industrial societies and less developed countries, no major country ever grew as rapidly as South Korea and Taiwan did during the 1960s and 1970s, or China has since the 1980s, and India and Vietnam are doing now.⁴ Thus, international *inequality* is an essential part of the advantages of backwardness. This inequality benefits those backward countries that grasp the available opportunities.

The advanced and relatively free countries are essential to generating the opportunities of backwardness. They provide a model, a source of technology, and a market for low-wage products. If the advanced countries became rich ahead of other countries because they established safe property rights for merchants and producers earlier than others, because they benefited from limited government earlier than others, because they invented capitalism and benefited from economic freedom first, then the advantages of backwardness are the effect of economic freedom or capitalism.⁵

Unfortunately, a lack of quantitative data prevents us from analyzing the impact of economic freedom on growth rates in the long run. But it is plausible to base a claim on qualitative data or narratives according to which the impact of economic freedom is strong. The advantages of backwardness

must have been small before the establishment of capitalism because most major civilizations (comprising tens of millions of people) then still had rather similar per capita incomes.⁶

Thus, the advantages of backwardness merit a Hayekian interpretation:

The benefits of freedom are therefore not confined to the free. . . . There can be no doubt that in history unfree majorities have benefited from the existence of free minorities and that today unfree societies benefit from what they obtain and learn from free societies.⁷

This statement fits the current relationship between the People's Republic of China and the West, as if it had been written yesterday and with exactly this example in mind. That the benefits of economic freedom in the United States and the West extend to statist societies was also pointed out by Henry Nau concerning Japan and other Asian states that developed earlier, such as Taiwan or South Korea:

The Asian model of development celebrated by strategic trade theorists works only in the context of the Anglo-American model of freer trade. No one has shown that Japan or any other Asian country would have succeeded in its trade and economic strategies, whatever the degrees of government intervention, if it had not had access to world markets, particularly the American market. To attribute such success to a superior development model, to domestic industrial, technology, and trade policy intervention, therefore, is at best a half-truth.⁸

A Different View of Global Inequality

So it looks as if economic freedom in the global economy, that is, the existence of dominant and pioneering free economies, is of paramount importance in improving growth rates and overcoming mass poverty everywhere. Moreover, economic freedom within nations, or the improvement of it, helps those who practice it.

Recognition of the fact of international inequality also has led to quite different evaluations. Recently, the World Bank bemoaned that “there are huge inequities in the world. Even better-off citizens in most of the developing world face worse opportunities than the poor in rich countries. The fact that the country of birth is a key determinant of people's opportunities runs counter to our view of equity.”⁹

Whatever the World Bank's concept of equity, this is at best an incomplete evaluation of the impact of the inequality between nations—which arose because of the establishment of property rights, economic freedom, and capitalism in the West before those achievements slowly spread elsewhere. If the early establishment of economic freedom had not enriched the West ahead of others, then there would be no potential advantages of backwardness for poor countries to

exploit. Thus, Western economic freedom not only generated the prerequisites of Western prosperity; it simultaneously established the precondition for overcoming mass poverty rapidly elsewhere.

Notes

This bulletin is based on Erich Weede, “Economic Freedom and Development: New Calculations and Interpretations,” *Cato Journal* 26, no. 3 (Fall 2006): 511–24.

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2. Robert J. Barro and Xavier Sala-i-Martin, *Economic Growth* (New York: McGraw Hill, 1995); William J. Baumol, “Multivariate Growth Patterns: Contagion and Common Forces as Possible Sources of Convergence,” in *Convergence of Productivity*, ed. William J. Baumol, Richard R. Nelson, and Edward N. Wolf (Oxford: Oxford University Press, 1994), pp. 62–85; and Mancur Olson, “Big Bills Left on the Sidewalk: Why Some Nations Are Rich, and Others Poor,” *Journal of Economic Perspectives* 10 (1996): 3–24.

3. Ronald Inglehart, *Modernization and Postmodernization* (Princeton, N.J.: Princeton University Press, 1997).

4. Angus Maddison, *The World Economy: A Millennial Perspective* (Paris: OECD, 2002).

5. Eric L. Jones, *The European Miracle* (Cambridge: Cambridge University Press, 1981); David S. Landes, *The Wealth and Poverty of Nations* (New York: Norton, 1998); Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990); Richard Pipes, *Property and Freedom* (New York: A. A. Knopf, 1999); Nathan Rosenberg and L. E. Birdzell, *How the West Grew Rich* (New York: Basic Books, 1986); and Erich Weede, *Asien und der Westen* (Baden-Baden: Nomos, 2000).

6. Maddison. Although Acemoglu, Johnson, and Robinson did not explicitly focus on limited government and economic freedom, they do argue that institutions dominate geography as a determinant of economic growth over centuries, and they provide some quantitative evidence from the last five centuries to support their view. Daron Acemoglu, Simon Johnson, and James Robinson, “Reversal of Fortune: Geography and Institutions in the Making of the Modern World Income Distribution,” *Quarterly Journal of Economics* 117 (2002): 1231–94.

7. Friedrich Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960), p. 32.

8. Henry R. Nau, *Trade and Security* (Washington, DC: AEI Press, 1995), p. 47.

9. World Bank, *World Development Report 2006: Equity and Development* (New York: Oxford University Press, 2005), p. 206.