Poverty, Freedom and Economic Justice

By

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The end of communism and the apparent triumph of capitalism had not brought to conclusion the endless debate about poverty. Although former communist regimes are struggling to establish a form of the market economy those countries with a collective memory of the practices and institutions of capitalism, such as Poland, Hungary and the Czech Republic, are doing rather better than those who had not experienced the essential concomitants of markets – the protection of property and a predictable rule of law embracing crime, contract and tort. Without these institutions society may degenerate into gangsterism, as in the former Soviet Union. In any event, these regimes cannot hope to match western countries for prosperity in the very short run but we should remember that the sometimes unpleasant face of Britain's Industrial Revolution concealed a rapidly growing market economy. Much wealth creativity was hidden behind ugly towns and a countryside ravaged by industrialisation. But despite what Marxist historians said, poverty was overcome in those years and the remarkable rise in living standards began in earnest then .[1] Too many students of the history of poverty have an approach to scientific objectivity about the nineteenth century that is little better than that of Charles Dickens.

Capitalism cannot deliver prosperity overnight and its triumph should not deceive us into thinking that all economic problems have been resolved with the end of the Soviet system. The poverty of former communist regimes might be temporary and at least their problems are theoretically amenable to the familiar prophylactics, but in the rest of the world there are appear to be countries whose abject conditions seem to be impervious to a quick solution via the implementation of the market, property and law. They are mired in permanent squalor, degradation and misery. Globalisation and the immense technological improvements that have accompanied it have not spread to all parts of the world. It is known that 1.2billion people lived on less than a dollar a day in 1998 and of these, 522million lived in south Asia, 291million in sub-Saharan Africa and 278million in east Asia. But the destitute also form big proportions of the population in these areas. Those protesters, at Seattle and Prague (of all places) against world free trade, allegedly on behalf of the world's poor, are either naïve, ill-informed or malevolent

Classical liberalism offers a uniform theory of the morality and the economy. The doctrine is such that, when properly applied, it requires no compromises between the demands of various principles (liberty versus justice, for example) and trade- offs between the community and the individual or social stability and economic success. These perfectly consistent principles emerge through the spontaneous development of market society. Societies are more likely to face internal dissent and disorder when *external* principles, most obviously extreme egalitarianism, are imposed on a natural order. The market system, because it emerges from the free choices of individuals, is not inconsistent with tradition, even though it might, appear, superficially, to be destructive of established ways of doing things. Does anybody really suppose that the commercial success of Japan[2] or Singapore has distorted their cultural traditions or torn the delicate fabric of their societies? Again, the tension within market economies between equality and liberty is overstated. Although there are vast holdings of private wealth in America the distribution of income is not noticeably more unequal than elsewhere. Indeed, under communism the inequalities of wealth and income were probably greater.[3] The way to end poverty is to integrate poor countries into the world economy and the invocation of community, equality and social justice as rival and competing principles are distractions from this task.

One thing is absolutely clear: the emergence and persistence of economic success does not depend on the lucky possession of scarce natural resources. It is true that there is a handful of small countries, with very low populations, which have benefited enormously from, say, oil, but if anything the relationship between natural resources and economic prosperity is inverse. The examples of Hong Kong and Nigeria are instructive. The former has little or nothing in the way of the gifts of nature but with the encouragement of entrepreneurship and the establishment of a reliable and predictable legal system, which sedulously protected private property rights, its commercial success became the envy of the world in the twentieth century and a magnet for economic migrants. By contrast, Nigeria has received $300,000,000,000 in oil revenues and remains mired in poverty and actual and incipient civil war. It is undoubtedly the case that the bulk of these revenues goes to the politicians who waste them on corruption and personal consumption and, often, war. If they had gone to private persons they would undoubtedly have been used for the benefit of the population. But because of the waste and corruption the *per capita* income of Nigerians is now back to what it was at the time oil was discovered in the late 1950s. Of course, many anti-western critics blame the multinationals (especially Royal Dutch Shell) for the current malaise (and environmental degradation) of Nigeria. But this is foolish; they have simply brought much-needed investment to a poor country. The fact that the income it has generated has been largely dissipated is not the fault of the companies. Neither is it their fault that the country has been beset by war, instability and military dictatorship.

It is undeniable that the world's poorest can only gain from an extension of the market ; with their low labour costs developing areas ought to be attractive to inward investment. The economic well-being of the poorest countries depends on their own efforts and not from the unreliable generosity of the richer nations. Hayek's "extended order" knows no boundaries and, in theory, the participants in it are guided by the desire to maximise profits (which creates more jobs and therefore greater wealth) rather than any nationalistic considerations. Only the untrammelled operation of this abstract order brings about salvation for the poorer nations. But its very abstraction is its major disadvantage, for people are more vulnerable to the allure of local and immediate advantages (from, for example, trade protection) than they are attracted to the benefits of international trade, which benefit, principally, *unknown* people.

Unfortunately, the record of the poorest countries in attracting inward investment is variable.[4] In 1999 the figure for sub-Saharan Africa was $55billion, or $86 per head, in India, Pakistan and Bangla Desh the aggregate figure was $27billion at $21 per head. But China had $306billion at $245 per head and Malaysia attracted an astonishing $49billion at $2121 per head. If the alleviation of poverty is to come about through the extension of the extended order two things (at least) are required. The home countries must remove all impediments to the market and richer nations must really open up the world to trade and commerce. This involves the assumption of significant economic and political responsibilities by all the countries involved. I will first of all look at the problem in relation to the poorest areas.

An obvious factor that explains the differences between countries with regard to attracting foreign investment is their general political stability; and in particular the protection they can give to property. Overseas capital will not be induced to invest if it is liable to confiscation and nationalisation or if profits are heavily taxed. Those countries that are perpetually plagued by civil war, as large parts of Africa seem to be, are not going to prove hospitable venues for investment. We should remember that the success of the west, and its lead in world economic development, was very largely a function of the establishment of reliable law and the gradual (and painful) elimination of fratricidal disputes based on religion. Unfortunately, the leaders of developing countries were at one time under the influence of Marxist social doctrines which refused to acknowledge the social utility of law: it was too often seen as a feature of the class system and regarded as the institutional arrangement by which wealth for the few could be protected rather than the essential method for the advancement of the common interest. This approach was cultivated even though the class system of developing countries did not conform to the Marxian, class-based model (although this itself was a false description of social reality).

But, irrespective of ideological considerations, the social environment of the poorest countries has not been at all conducive to economic progress. Civil wars, not wars between nations, are probably the biggest impediment;[5] out of 27 conflicts in 1999 25 were civil and occurred almost exclusively in poor countries, most often in Africa. Some of these conflicts are funded by wealthy diaspora, always anxious to support a grievance back home. Poverty is always an enormous incentive to civil war and Africa's problems emanate from its underdevelopment and abject social conditions. It cannot be stressed strongly enough that the continent has performed absolutely and relatively badly in comparison to other countries. As Mancur Olson points out, in a recent and posthumously published book,[6] there are different types of civil conflict which can have significantly different economic effects. There are roving gangs of bandits which prey on others. Because the country is already unstable they have no incentives to establish any permanent institutions and just exploit on a temporary basis whoever possesses something. And there are also “stationary” bandits, who often come from a dominant ethnic group. Since they are likely to be permanent predators they have an incentive to establish some public services, suppress rival bands and guarantee some sort of infrastructure (however minimal). Of course, the stationary bandit is quite unlikely to increase the well-being of the general community, only a selected part of it will gain, but he will provide a kind of predictability. The worst thing that can happen to a nation is for it to be subject to roving bands of anti-social predators, often poorly educated young men who have little else to do but to rob. They have no future in their own countries.

Only the elimination of poverty (and the reduction of a country’s dependence on a primary product) will diminish the tendency to civil war. There is only a little the west can do to soften the grievous effects of what may seem to be pointless conflicts. But certainly economic aid, if it is to be given at all, which is itself contentious, should be so designed that it encourages political stability. It should be withdrawn instantly if it is spent on the pursuit of fratricidal goals or it simply lines the pockets of the predators. Sometimes the west may have to support the strongest group in a dispute, irrespective of the rights and wrongs of the case, because that is the only method of securing some of stability. The best long-term hope for poverty-stricken countries is to integrate them into the world economy so that the incentives for destructive conflicts are removed.

At the more general level there is much more western countries can do to alleviate world poverty. Most important of all it can guarantee open markets and eliminate the privileges countries normally guarantee for their own workers. It was noticeable that at the Seattle demonstration against globalisation, naïve, heady young idealists, campaigning against world poverty, were in alliance with trade unionists from the north east of America who were anxious to protect their members from competition from cheap labour in the developing world. The latter had no interest in world poverty but every incentive to preserve the privileges of their members. But the extended order is threatened often by rent-seekers *within* capitalist regimes. All those who sincerely believe in the amelioration of world poverty have a moral and economic duty to encourage the forces of genuine globalisation; for only the development of a *world* market will breakdown those groups and institutional powers that prevent the trickling down of wealth to the very poorest in the world. The European Union, with its highly protectionist Common Agricultural Policy, is perhaps the most to blame for squeezing out the poorest agricultural producers from world markets. This will also be a problem when former communist regimes enter the Union. For countries like Poland, which have significant farming sectors, will have to be subsidised at European levels, which could well bankrupt the Member States, or a proper market will have to be created in which Poland can compete (and drive richer farmers from France and Germany out of business). Whatever happens, the resulting mayhem will illustrate all too well the poverty-inducing policies of rich countries.

Another thing that the west can do to tackle world poverty is to refrain from imposing its high standards of worker protection and environmental regulation on poorer countries. It must be remembered that these highly restrictive rules are not *necessities*, without which there would be less or no production. They are the subjective choices of richer countries which can afford them (although there is no reason why they should be made compulsory for all citizens of these states). But by making them obligatory for international trade, the rich are, in effect, imposing a form of protectionism on the poor countries. Very strict environmental regulations are a luxury of the west; only as counties get richer do they value clean cities and an unspoilt countryside more than extra jobs. However, poorer nations might very well rank jobs higher. As they emerge out of poverty they may very well prefer the standards of the west: but this is a matter of *subjective* choice, there is no objective environmental strategy.

Freedom

Implicit in what has been said so far is a commitment to the foundational value of liberty. This has been approached from a utilitarian perspective. The freedom of the market is the source of prosperity in the world; indeed former communist regimes are desperately trying to imitate it. Of course, there is a non-utilitarian tradition of liberty, perhaps deriving from natural rights or from the idea of self-development pioneered by John Stuart Mill (who still thought of himself as a utilitarian) but I should like to concentrate mainly on orthodox consequentialism here. Economics uses liberty in an instrumental sense. It takes people's choices as 'given' and works out the logical consequences, for prices and protection, of their being implemented in markets. It makes no logical difference whether a consumer chooses books and clothes or heroin and cocaine. Are the latter really free choices? This is a question that bothers philosophers rather than economists.

But apart from the philosophical conundrums about freedom that derive from the above example there are still more complex problems that emerge from the connection between economics and liberty. Most of the orthodox market criticisms of government intervention flow from a consideration of the operation of laws that in a sense restrict our liberty. Rent control, by reducing the supply of housing, always produces homelessness; minimum wage laws, by fixing the price of labour above its marginal productivity, inevitable causes unemployment since it would be irrational for employers to hire labour whose marginal productivity is less than the government-decreed wage; and Keynesian macroeconomic policies, through operating in defiance of constraints on the supply of money, inexorably generate inflation.

Indeed, market socialists were so convinced of the predictability of human behaviour that they proposed that the efficient outcomes of the market could be reproduced artificially without the inevitable imperfections (monopoly etc) of real markets. What the market socialists, and other interventionists, failed to see was that real, striving and maximising individuals, acting in a world of uncertainty, are constantly correcting imperfections in the market. Their actions co-ordinate the dispersed knowledge that exists in the real world. Such knowledge is often temporary and fleeting ('the knowledge of time and place') and is not available to the central planner; he can only handle static and unchanging knowledge. He deals with *given* tastes and *given* production costs and simply rearranges them; but these are changing all the time. Even the advantages of the monopolist are temporary, forever vulnerable to new discoveries by individuals in search of profit. This is the role of the entrepreneur: to spot gaps in the market, to anticipate future demand and to be one step ahead of his competitors. Competition is never 'perfect' and static but *rivalrous* and unpredictable.

That critic of the market, John Kenneth Galbraith thought that large-scale corporations were so powerful that they could control markets and were immune from any kind of competition. They never faced bankruptcy and could resist any innovator who threatened their position. However, a glance at the New York stock exchange reveals that at least eight leading companies (out of the top twenty) are less than ten years old. The technological revolution of the last decade is a tribute to the fecundity of the *free* market. Thus although it is true that, in a sense, the economic world is governed by 'iron' laws, they merely put boundaries on actions which are performed by human beings with their own plans and purposes; they do not dictate the behaviour of these persons.

The features of freedom identified here do not solely belong to the world of advanced industrial societies, to Wall Street or the City of London: they are a feature of all human action when it is faced with scarcity and the necessity of choice. Those who planned the economic destiny of post-colonial Africa neglected the fact that the continent already had well-developed market systems[7] and foolishly imposed western-designed economic arrangements which were entirely inappropriate there; for example, embarking on massive capital investment when there was an abundant supply of local labour. The planners tried to work independently of the 'tacit' knowledge that already existed in Africa. This information cannot be expressed or articulated in a formal manner (put into diagrams and equations) but it is essential for the co-ordination process. There is no doubt that the misapplication of economic theory is an important explanation of the poverty that persists in Africa and in other parts of the under developed world.

Unfortunately, in modern American ‘liberalism’, economic freedom has been seriously devalued. The freedom to exchange, to accumulate property and be independent of government has little value compared to liberty of expression, the separation of church and state, or a woman's right to choose. I do not say that these are necessarily unimportant but I do insist that there is no conceptual difference between them and the traditional economic liberties. Yet the later have had no serious constitutional protection since 1937.[8]

In at least two areas economic liberty has been badly compromised in the west: they are in contract and property. At one time each person was thought to be a rational agent, capable of determining his or her own future and able to bear full responsibility for the choices he or she makes. This is a moral argument, as well as a purely economic, one for it strongly implies that individuals know their own interests best and do not need the guiding hand of a paternalistic state. But now the right to contract is hemmed in by all sorts of restrictions. The European Union has recently put a restriction on the number of hours a person may work in a week. How do the bureaucrats in Brussels know this? Apart from its deleterious effect on efficiency this restriction is the denial of a fundamental human right. Another serious limitation on contract has developed (by a combination of case law and statute) in the United States. This is the way in which tort law has gradually over-ridden contract. It is virtually impossible for individuals to contract their way out of tort liability. Victims of accidents can always sue for extensive damages whatever warning signs about safety producers may have displayed. Efficiency is seriously hampered in America as manufacturers are deterred by the fear of law suits. It has also led to massive rent-seeking by lawyers

These examples, plus the rise of a compulsory and all-encompassing welfare state, have significantly reduced freedom in the west. Of course, philosophers have dreamt up all sorts of rationalisations to justify the familiar intrusions into the private world. Most of these involve subtle manipulations of the meaning of liberty. I have been using freedom so far in its negative sense.[9] To be free is not to be restrained: by law or other forms of coercion. This meaning says nothing about the *quality* of an act: a person is free to the extent that he is not restrained by law. In contrast, positive theorists of libery identify free acts in terms of their rational features; thus the choices of my aforementioned drug consumer would not be genuinely free. The state has therefore considerable philosophical license to act "coercively" so as to increase liberty.

Modern theorists of positive liberty, anxious to avoid the definition of freedom in terms of rationality (and its Rousseauistic implications), now identify liberty as *autonomy*. A person is only free if his actions stem from his genuine, unfettered self and are not determined by outside forces. Thus extreme poverty limits liberty because someone in that condition does not act autonomously but under the pressure of forces beyond his control.. Someone compelled to accept a low paying job because the alternative is destitution is as unfree as someone who obeys the command of a gunmen. Thus state action to eliminate such circumstances does not merely relieve poverty, it enhances freedom. Others, compelled to pay for this state activity, which normally goes beyond poverty relief, are also liberated – from the restraints of selfish desires. Indeed, many theorists of liberty as autonomy are also communitarians. They repeatedly denigrate the market for its apparent failure to generate communally-valued goods.[10] Other choices in the market, for frivolous goods and services, might not be genuinely free. Anti-market writers, like John Gray,[11] are particularly scathing about globalisation because of its threat to long-established communities.

The hostility to choice revealed by these writers is alarming. It is, of course, true that many people do not lead autonomous lives. In traditional societies they obey rules and follow customary practices without thinking. Their behaviour might be described as habitual rather than autonomous. In modern society we think of football hooligans, or followers of teenage fashion, as being similarly blighted by the affliction of non-autonomous choice. But we should remember that autonomy has an *opportunity* cost: the time spent on acquiring the capacity to make fully-informed and rational choices could be spent in the pursuit of other utility-maximising activities. And the latter activity would be perfectly free and rational in the economist's understanding of these terms. To be fully autonomous requires that we be *already* free in the sense of not being constrained. Negative liberty always, then, precedes autonomy. The latter can, then, be seen as just another choice and one that only intellectuals are likely to make.

Most of these philosophical speculations on the meaning of liberty have little relevance either to citizens of former communist regimes anxious to restore the market and to approach the prosperity of the west or to those in dire poverty. It is not really significant if market action to relieve the suffering maximises their autonomy or their utility in the conventional economist's sense: the important point is that their *welfare* has been improved. In almost all cases that concept ought to be understood subjectively.

Justice

Rather like liberty, the word justice has been traduced over the last five decades and made to describe political and social phenomena to which it would have been thought irrelevant by the social and political theorists of the past. Even before the collapse of communism, the demand that government should implement *social* justice had become the mantra of progressive thinkers. But while social justice clearly does compete with the market and classical liberalism, a proper understanding of justice reveals that it is perfectly harmonious with liberty, the market and welfare. We do not have to sacrifice a little bit of justice to get more welfare, or liberty, for the ideas hang together in a consistent manner. On the other hand, social justice has nothing to do with proper justice, liberty or welfare justice but is simply an aspect of that egalitarianism which has always been antithetical to a free and prosperous society.

It might be wise to distinguish traditional justice as *procedural* and social justice as *end-state*.[12] Procedural justice refers to those basic rules which any organisation must have if it is to be a predictable order; one in which participants can know with more or less certainty how the rules will affect them. They can plan their lives accordingly. A market system, subject to rules which protect property and enforce contract, is a good example of this. Here, justice simply relates to individual action under the rules and has nothing to say about the outcomes of the process, be it egalitarian or highly unequal. Words like desert or merit, or even need, have no relevance to the distribution of income that emerges from the operation of the market. The appropriate word is *value*, and the income people earn is entirely a function of the value they create for others, as revealed in exchange. There may be legitimate arguments about the starting point for such a process, especially in relationship to land ownership, but it is maintained that there are no sensible disagreements about final incomes as long as they are earned though trade and labour productivity. The value that is created reflects anonymous people's free choices in the market. That which is valued is prized by the members of a free society, it is not determined by the state (that is, by individual officials who have the power to make such determinations in socialist, and less than socialist, societies). For a classical liberal, the subjective judgements about value, made by people in the competitive market, are infinitely preferable to the equally subjective judgement of officials subject to no genuine market correction but only ineffective political control. Politicians are monopolists whose actions are validated by elections perhaps once every four or five years while business agents are subject to the continuous referenda of the markets.

This view of justice is normally utilitarian. It presupposes that there is no distinction between the laws that govern production and those that govern distribution; thus the earning of the factors of production exactly reflect their contribution to the total outcome (productivity) of the process. If there is interference with distribution, by the invocation of an equality not justified by the marginal productivity of labour, then this will have an unfortunate effect on the total product of the market. If labour is subjected to heavy taxation it will withdraw from the market; people will prefer leisure over work, making everybody worse off in the long run. Ultimately, to maintain labour productivity workers might have to be directed to occupations by force: this is Hayek's 'Road to Serfdom' thesis.

In direct contrast, end-state or social theories of justice are specifically concerned with outcomes or end-states. No matter how rigorously the procedural rules are followed if the resulting distribution of income fails to meet some moral criterion then it is unjust and must be corrected by the state. John Stuart Mill is perhaps the originator of modern theories of social justice for he suggested that there is a distinction between the laws of production and the laws of distribution. He said that the former were fixed, like laws of nature, and could not be altered by human contrivance while the latter were subject to human manipulation: it is permissible therefore to implement an external moral principle like desert or need. Although most commentators, and not just free market ones, regard Mill's distinction as being absurd, altering distributive returns does have an effect on the outcome of a market process, it has nevertheless turned out to be an extremely popular ethic amongst interventionists, especially when taken in conjunction with the doctrine of the diminishing marginal utility of income.

Modern theories of social justice use desert and need to validate state-driven alterations of the results of spontaneous markets. Certain occupations, financiers or popular entertainers, for example, are thought not to merit their very high earnings, while many of those who fall lower down the scale, nurses and teachers perhaps, are worthy of higher incomes. There is a general agreement that the market does not measure correctly people's social value. But there really is no agreement about proper earnings; in practice, when we take away the market they are decided by powerful interest groups.

However, the more sophisticated of the modern theories of social justice tackle directly the utilitarian features of market theory. They argue that much of the income of high earners is 'rent': payment to them for the possession of a lucky talent for which they have no alternative use. Taxing away this would not lead to loss of output since the owners of that talent have little else to do with their skills. Efficiency then is consistent with social justice.

Classical liberals deny that this income is rent and insist that taxing it away would lead to serious loss in output. Furthermore, in a globalised economy with, no labour restrictions, high earners would soon find an outlet for their talents overseas and earn a market-determined return. However, it is at this point that the market argument itself takes on a moral aspect: this turns upon the concept of self-ownership. People own their natural abilities, they are a part of their personhood, and to take them from persons through high taxation is not just equivalent to theft, it is almost like slavery. But the most fashionable of modern theorists of social justice, John Rawls,[13] denies precisely self-ownership. He says people do not own their own talents and do not therefore deserve the income they generate; they are a gift from nature and available for redistribution to society at large. Inequalities are only permissible if they are conducive to the well-being of the least-advantaged.

There are many theoretical difficulties with Rawls's doctrine[14] but we can locate one immediately. It is a very abstract model (as originally formulated[15]) and its egalitarian principles are of world-wide application. If we are really concerned about the least advantaged, and we have no right to our natural talents, then there really is no limit to the morally-permissible redistribution from rich to poor countries. In fact, the redistribution required to make a significant difference to the most poverty-stricken in the world would not be all that burdensome. It has been calculated that the wealth transfer needed to double the incomes of the world's 1.2billion poorest people is scarcely more than 2% of the output of the richest economies. But even for the most extreme egalitarians, redistribution tends to stop at their own borders. There is no politician in America and Britain that has gone into an election with an altruistic manifesto to satisfy anything approaching Rawls's criteria.

Irrespective of this, the utilitarian arguments against even a theoretical account of social justice are surely persuasive. It is much better if poor countries establish the rule of law, entrench property rights and encourage the freedom of the entrepreneur than rely on handouts from the rich. And here the lesson is universal, for it applies with as much force to the domestic economy as it does internationally. All should resist the siren of social justice: for its temporary allure will lead us to permanent economic distress.

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[1] See Max Hartwell, *The Long* Debate on Poverty, London, Institute of Economic Affairs, 1978.
[2] Marius B. Jansen, The Making of *Modern Japan, H*arvard University Press, 2000.
[3] This is so even if we ignore the massive political inequalities.
[4] See Martin Wolf, 'Spreading the World's Wealth', *Financial Times,* December 2, 2000.
[5] See Martin Wolf, 'How Civil War Plagues the Poor, *Financial Times*, December 27, 2000.
[6] *Power and Prosperity*, New York, Basic Books, 2000.
[7] Peter Bauer has made an extensive study of this. See *From Subsistence to Exchange*, London, Oxford University Pess, 1999.
[8] See Norman Barry, 'The Constitutional Protection of Economic Liberty', *Ideas on Liberty*, November, 2000.
[9] For an account of the various types of liberty, see Norman Barry, *An Introduction to Modern Political Theory,* London, 4th edition, 2000, ch. 8.
[10] See Joseph Raz, Oxford, Clarendon Press, 1986.
[11] See especially, *False Dawn,* London, Granta Books, 1998.
[12] See Norman Barry, *An Introduction to Modern Political Theory*, ch. 6.
[13] *A Theory of Justice*, London, Oxford University Press, 1972.
[14] Barry, *An Introduction to Modern Political Theory*, pp. 156-67.
[15] Rawls has recently changed the theoretical foundations of his model, see his *Political Liberalism*, New York, Simon and Schuster, 1993.