

## **Economic Freedom: The Forgotten Human Right**

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Human rights are an essential rallying point for fighters of freedom. They are largely a bundle of various rights or freedoms like the right to life, freedom of expression, freedom of religious practice, right to vote and participate in a democratic set-up. Generally when these political rights or civil liberties are listed, an important set of rights and freedoms—economic freedoms are left out. Even the UN declaration of human rights hardly dwells on economic freedom. The freedom to produce and trade without any encumbrance—economic freedom—is just as important as the right to free expression.

### **Rights, Not Entitlements**

Economic freedom and economic entitlements are rather different, in a fundamental sense, they are an antithesis. A variety of “new economic rights” are bandied around: the right to education, health care, and housing being the most conspicuous. A distinction must be made between a right to the process of producing or acquiring goods and services and a right to the goods and services themselves. For example, the right to freedom of expression simply means that we can express ourselves without fear or favour. It does not entitle us to a free printing press or radio / TV station for broadcasting. Neither does it entitle us to use the intermediary of the government to acquire use of someone else’s printing press or radio station. Nor is the government required to provide a printing press or radio station to every one who wants to exercise the right to free expression. It only requires that no one should interfere in our exercise of that right; no one is compelled to provide us the means to exercise that right. In the same vein, the right to education should mean that no one can stop us from producing and obtaining education, not that somebody has to provide us education. The right to the pursuit of happiness and the right to happiness are fundamentally antithetical. So is economic freedom and economic entitlements.

### **Benefit to the Poor from Economic Freedom**

Economic freedom is not just for rich capitalists. It is more critical for those at the bottom rung of the economic ladder—nobody appreciates capitalism more than the poor hawker or peddler. Economic freedom entails the removal of various licences and laws under which citizens live. A lack of freedom and excessive regulation affects the poorest hardest. One small example is the plethora of regulations covering cycle-rickshaw pullers in Delhi. Delhi has approximately two hundred thousand cycle-rickshaws providing an affordable and available service compared to buses or auto-rickshaws. The Municipal Corporation of Delhi has mandated that rickshaw pullers have to be licensed and only 50,000 licences shall be given out. In one fell sweep three-fourths of cycle-rickshaws are now illegal operations. Another irrational rule is that the holder of the cycle-rickshaw has to ply his cycle-rickshaw himself, the owner and the driver must be the same person. You can own multiple taxis or auto rickshaws or buses—but not the cheapest means of transport—the cycle-rickshaw. The law basically says one person can own only one cycle-rickshaw: No room for growth for individual owners in the cycle-rickshaw business. And we wonder why we are unable to eradicate poverty!

What use is economic freedom for a person with an empty stomach? That is the standard refrain when one talks of economic freedom. However, as our example of cycle-rickshaw pullers shows, economic freedom is critical in earning an honest living. In a sense economic freedom is the freedom to carry on with your livelihood. More importantly, it is in the nature of freedom that even if I do not exercise it, its use by others confers benefits to me. A poor illiterate person may be unlikely to exercise his freedom of expression, but the fact that others in his society have that freedom provides him tremendous benefits.

Lack of economic freedom also affects fulfilment of our social objectives, of universal education and healthcare, for example. The Delhi Education Act of 1973 requires an “Essential Certificate,” a license, from education authorities for opening a new school or even for expanding an existing one. The authorities are required to assess “any adverse impact” of the opening of a new school on the existing ones in the area. The license-permit raj that ruled the industry in India until 1991 still operates in the field of education. Severe

scarcity of schools and poor quality of education are the predictable results of the license-permit raj in education. Economic freedom is as much a solution in education as it is in industry.

### **Economic Freedom and Social Welfare**

The denial of economic freedom is sought to be justified by citing social welfare. Government regulations are for the good of all and without them the market would run amok and provide sub-standard goods and services at exorbitant prices. Monopolies and restrictive trade practises, the argument says, would be unchecked without the controlling hand of the government.

A closer dispassionate look at how markets actually function clears misconceptions and shows how the market adapts and corrects itself. All players in the market have the same rights of production and trade. They have to compete amongst each other and constantly keep providing a better and cheaper product or service. If any one manufacturer is too lazy or greedy, he would see his market share eroded by others who would move in to make up for the slack. With a wide variety of goods and services on offer, consumers would gravitate towards those with the best quality at the cheapest price. Competition, therefore is a better guarantor of keeping prices low and quality high than government licensing and regulation. Manufacturers and service providers have a far greater incentive to self regulate, otherwise they lose their goodwill, market share, profits. Under free and open competition, greed of one businessperson is a better check against the greed of other businesspersons than the benevolent hand of the government.

### **Measurement of Economic Freedom**

Recently a different approach—quantitative instead of philosophical and theoretical—to understanding the significance of economic freedom has been tried. Following the Freedom House's successful assessment of political / civil freedoms, several attempts have been made to quantify the degree of economic freedom in the country. The Freedom House in New York, Heritage Foundation in Washington, D.C., and the Fraser Institute in Vancouver, all three of them have developed indices to measure economic freedom. The Centre for Civil Society is a co-publisher of the Fraser Institute's *Economic Freedom of the World*; so I am more knowledgeable about it.

The Fraser Index of Economic Freedom takes into account seven different areas including how large a government is and how much it interferes into the working of the economy via government enterprises, price controls and tax rates; monetary policy including the ability to control inflation; the efficiency of the country's legal institutions especially ones to protect property rights; freedom of citizens to trade domestically and internationally, and freedom to use and maintain bank accounts in alternate currencies. The detailed component list is as follows:

### **Components of Index of Economic Freedom**

#### **I. SIZE OF GOVERNMENT: CONSUMPTION, TRANSFERS, AND SUBSIDIES**

- A. General Government Consumption Expenditures as a Percent of Total Consumption
- B. Transfers and Subsidies as a Percent of GDP

#### **II. STRUCTURE OF THE ECONOMY AND USE OF MARKETS (Production and allocation via and political mandates rather than private enterprises and markets)**

- A. Government Enterprises and Investment as a Share of the Economy
- B. Price Controls—Extent That Businesses Are Free to Set Their Own Prices
- C. Top Marginal Tax Rate (and income threshold at which it applies)
- D. The Use of Conscripts to Obtain Military Personnel

#### **III. MONETARY POLICY AND PRICE STABILITY (Protection of money as a store of value and medium of exchange)**

- A. Average Annual Growth Rate of the Money Supply during the Last Five Years minus the Growth Rate of Real GDP during the Last Ten Years

- B. Standard Deviation of the Annual Inflation Rate during the Last Five Years
- C. Annual Inflation Rate during the Most Recent Year

IV. FREEDOM TO USE ALTERNATIVE CURRENCIES (Freedom of access to alternative currencies)

- A. Freedom of Citizens to Own Foreign Currency Bank Accounts Domestically and Abroad
- B. Difference between the Official Exchange Rate and the Black Market Rate

V. LEGAL STRUCTURE AND PROPERTY RIGHTS (Security of property rights and viability of contracts)

- A. Legal Security of Private Ownership Rights (Risk of confiscation)
- B. Viability of Contracts (Risk of contract repudiation by the government)
- C. Rule of Law—Legal Institutions, Including Access to a Non discriminatory Judiciary, That Are Supportive of Rule of Law Principles

VI. INTERNATIONAL EXCHANGE: FREEDOM TO TRADE WITH FOREIGNERS

- A. Taxes on International Trade
- B. Non-tariff Regulatory Trade Barriers

VII. FREEDOM OF EXCHANGE IN CAPITAL AND FINANCIAL MARKETS

- A. Ownership of Banks: Percent of Deposits Held in Privately Owned Banks
- B. Extension of Credit: Percent of Credit Extended to Private Sector
- C. Interest Rate Controls and Regulations that Lead to Negative Interest Rates
- D. Restrictions on the Freedom of Citizens to Engage in Capital Transactions with Foreigners

Out of the seven SAARC countries, Bhutan and Maldives are not ranked by the Fraser index. The rating of the remaining five SAARC countries for the seven components and their global ranking for 1997 is as follows (the higher the rating, the more the economic freedom; but the lower the rank, the higher the economic freedom):

<i>Components</i>	<b>Bangladesh</b>	<b>India</b>	<b>Nepal</b>	<b>Pakistan</b>	<b>Sri Lanka</b>
I	9.9	8.0	9.0	8.3	8.7
II	2.0	3.5	2.9	4.6	5.3
III	9.0	8.7	8.7	8.4	8.9
IV	3.2	7.0	2.8	4.5	4.9
V	6.9	7.6	--	7.0	7.6
VI	--	4.1	6.6	5.0	5.8
VII	3.5	3.8	3.8	3.2	6.0
<b>Summary Rating</b>	<b>5.3</b>	<b>5.8</b>	<b>5.3</b>	<b>5.6</b>	<b>6.5</b>
<b>Overall Ranking (out of 123 countries)</b>	<b>94</b>	<b>86</b>	<b>94</b>	<b>88</b>	<b>66</b>

Sri Lanka (ranked 66 out of 123 countries) has the highest degree of economic freedom among all ranked SAARC countries, while Nepal and Bangladesh have the lowest (both ranked 94). All the ranked SAARC countries have a good score on components I (Size of Government) and III (Monetary Policy). This has been true since 1970 except for a few lapses. The size of government score has ranged between 8 to 8.9 for India, 8.1 to 8.7 for Sri Lanka, 8.3 to 9.4 for Pakistan, 8.8 to 9.5 for Nepal and 9.9 to 10 for Bangladesh.

A shift in India's economic policy took place in 1991 when central planning appeared to give way to market forces. The large increase in the economic freedom rating of 1.7 points during the 1990s in marks that shift. But, in relative terms this improvement has barely kept pace with the liberalisation of the rest of the world. India's rank only improved from 93<sup>rd</sup> (out of 115) to 86<sup>th</sup> (out of 123) in the 1990s.

The score of 4.1 on Component VI: International Exchange clearly indicates the long path India still has to travel, even though this is the area where India has seen the most improvement. The ratings for Area II: Structure of the Economy and Use of Markets and Area VII: Freedom of Exchange in Capital and Financial Markets suggest that the state control of the domestic economy through price controls, nationalized banking and insurance industry, and public sector enterprises has seen little change.

The improvement in Area V: Legal Structure and Property Rights indicates the increasing independence of the judiciary and of the agencies that supervise the government, like Central Vigilance Commission, Comptroller and Auditor General, and the Election Commission. The changes in the components of the Index provide reason for guarded optimism.

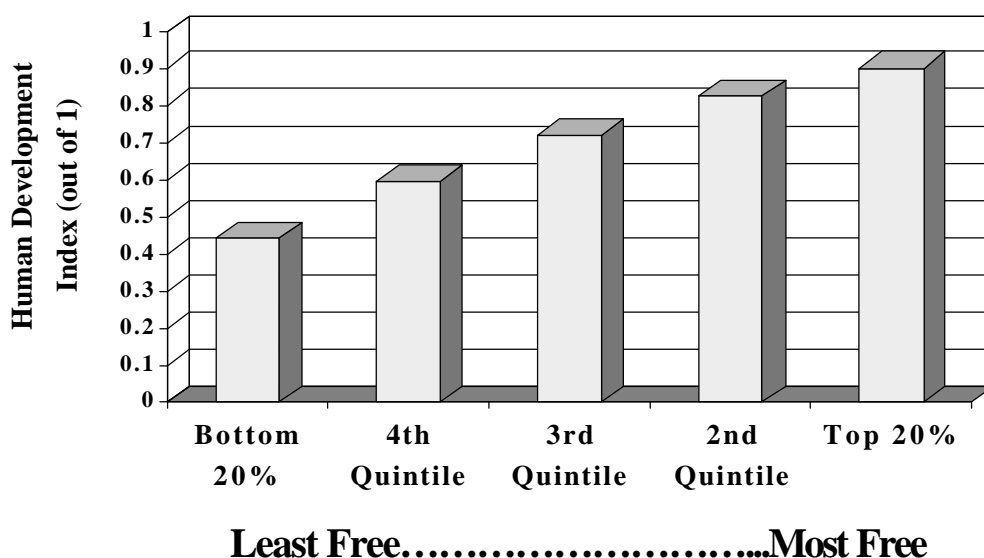
**Economic Freedom and the Quality of Life**

An important question to ask is: does economic freedom really make a difference in living standards? The facts tell a fascinating story. The Fraser index shows astounding differences in economic and social outcomes between nations that are more economically free than those that are less free. Life expectancy is 20 years longer for people in the 24 most free countries (the top 20%) than in the 24 least free countries (the bottom 20%). Average income per person in the top 20% was \$18,000 in 1997, compared to less than \$2,000 for the bottom 20%.

The following two graphs show that the economically most free countries have the highest real growth in GDP and the highest per capita income of all countries. The economically least free countries suffered a negative real growth in GDP over 1990s—their economies shrank.

Even social indicators reveal a wide gap between the economically free and not so free. For a variety of social and political indicators, economically freer countries fared better. The average Human Development Index for the top 20% is 0.9 compared to less than 0.45 for the bottom 20%. This goes to show that countries in the top 20% have far lower rates of adult illiteracy and poverty, higher labour productivity, and better access to safe drinking water.

**UN Human Development Index  
Rating by Economic Freedom Quintile**



Conventional wisdom tells us that richer countries have more inequalities. The long bar on the right of each sub section in the following graph shows how much wealth is concentrated in the hands of the richest 20% of the population. It is roughly the same everywhere. The only significant difference is in the economically freest countries where the richest 20% control 40% of the wealth compared to more than 45% everywhere else. Economic freedom not only enhances the rate of growth, but also engenders economic equality.

An easy way to check for income inequalities is to compare the lifestyle of the nation's "first family" i.e. the family of the President / Prime Minister with that of an average family. Invariably the gap is much narrower for those countries that are economically more free like the United States or Switzerland than economically less free countries like India or Pakistan or North Korea. The regular (not state or official) lunch or dinner menu of President Clinton is more or less the same as an average American, while the difference is undoubtedly larger in India or North Korea.

The quantification of economic freedom has allowed social scientists to assess its importance in economic development. A growing literature now supports the wisdom of Adam Smith: Economic freedom is critical in achieving higher rates of development. Importantly, simply changing the legal and regulatory system, i.e. the functioning of the government, we can increase economic freedom. It can be done far quickly compared to building infrastructure, providing basic education and healthcare, and developing technologies and know-how.

In protecting dignity of the individual and in building a good society, economic freedom is as critical as political and civil liberties. Economic freedom—freedom of production and trade—must be an essential component of basic human rights.

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