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Economic Freedom – The Key to Prosperity

The Economic Freedom Fighters (EFF) want 'economic freedom' for the black majority, to be achieved by nationalising mines and expropriating land without compensation. The African National Congress (ANC) has similar ambitions, as the Freedom Charter shows. But the EFF/ANC idea of economic freedom contradicts the general global understanding of the term, which emphasises individual choice, protection for property rights, and respect for market principles.

Economic freedom, in the true sense of the term, stimulates investment and employment. It makes for faster economic growth and increased prosperity for all, including the most poor. Economic freedom can also be measured and its benefits assessed in terms of hard statistical data, as the Fraser Institute of Canada has been doing for many years via its global index of economic freedom.

Once apartheid ended, South Africa could have risen steadily up the Fraser Institute's index. Instead, as state intervention has intensified, so its ranking has deteriorated, as the 2014 index again reveals. If South Africa follows the EFF/ANC narrative still further, it could slip into the 'least free' category of countries. In such states – which include both Zimbabwe and Venezuela – growth is negative or minimal, and poverty intensifies for everyone except a small political elite.

The EFF, the ANC, and economic freedom

In the May 2014 general election, Julius Malema and his flamboyant Economic Freedom Fighters won 25 seats in the National Assembly and 6% of the national vote. The EFF say they want 'economic freedom' for the black majority, to be achieved through the nationalisation of the

mines, the expropriation of land without compensation, and a state-directed programme of industrialisation behind high tariff walls and other barriers to global trade. Since many of these proposed interventions are barred by the Constitution, the EFF also wants 'the dismantling of the elite pact forced on the people in 1994'. Moreover, as Mr Malema recently told President Jacob Zuma, the ANC 'can no longer make the excuse of [not having a] two-thirds majority [to change the Bill of Rights] because the EFF can give it to you now'.

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Few commentators take the EFF very seriously, for its 6% of the vote lags far behind the 62% won by the ruling African National Congress (ANC) in the last election. However, the ANC in fact has many of the same ambitions as the EFF. For example, the Freedom Charter of 1955 speaks of transferring 'the mineral wealth beneath the soil, the banks, and monopoly industry' to 'the ownership of the people as a whole'. It also pledges to 're-divide the land among those who work it'. Moreover, the ANC regularly describes the charter – drawn up some 60 years ago with significant communist input – as its abiding policy 'lodestar'.

In addition, the ANC remains deeply committed to a national democratic revolution (NDR) aimed, among other things, at 'eliminating' existing property relations. The ruling party shares this objective with its allies in the tripartite alliance: the Congress of South African Trade Unions (Cosatu) and the South African Communist Party (SACP). Both Cosatu and the SACP openly identify the NDR as providing the fastest and most direct route to socialism and then communism.

In the interim, the tripartite alliance remains intent on bringing about 'radical socio-economic transformation' in this 'second phase' of the national democratic revolution. Like the EFF, the ANC also claims that increased state intervention will bring about 'economic freedom' in South Africa. This makes it important to understand what the ANC and EFF mean by this term.

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The ANC and EFF definition of 'economic freedom' is based on Marxist ideology, which is adamant that 'economic emancipation' can never be achieved under capitalism. In addition, though South Africa gained its independence from Britain more than a century ago, both the EFF and the ANC proclaim a continuing need to free the country from the 'economic bondage' of its colonial past.

In the ANC/EFF perspective, South Africa was long subject to 'colonialism of a special type': a system in which the white minority was effectively a colonising power and the black majority was its colony. White wealth, they say, thus has nothing to do with skills, enterprise, or technological advantage but derives solely from a ruthless exploitation of the black majority. The only way to overcome this historical injustice and bring about 'economic freedom' from persistent oppression is through a comprehensive redistribution of land and other resources from white to black South Africans.

The ANC/EFF concept of economic freedom is very different from the general understanding of this term across the world. Definitions of economic freedom have, of course, varied to some degree since 1776, when Adam Smith published his famous book, *The Wealth of Nations*. However, the term usually connotes individual liberty, freedom to trade, and respect for market principles, property rights, and the rule of law. Since the late 1980s, the concept has been further refined by the Fraser Institute of Canada, which (in combination with other scholars) has found a way of measuring economic freedom and quantifying the benefits it brings.

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The beginnings of the economic freedom index

The idea of defining economic freedom in a measurable way emerged in 1984, at a meeting of the Mont Pelerin Society, a group formed in 1947 to study the virtues and defects of market-oriented economic systems. Delegates asked whether George Orwell's powerful book *1984* had erred in predicting the emergence by that year of an all-encompassing and intrusive totalitarian state. The spread of democracy to many countries suggested that Orwell had been off the mark, as political freedom had become widespread. But the Fraser Institute's Michael Walker raised the question whether political freedom and economic freedom were the same thing. In response, economist Milton Friedman said it would be fruitful to define economic freedom in measurable terms and then start looking for empirical evidence of its effects.

Following on from this Mont Pelerin meeting, Professor James Gwartney of Florida State University and his post-graduate student Robert Lawson (now a professor at the O'Neil Center for Global Markets and Freedom in Texas) came up with the idea of creating an 'index' of economic freedom. Data used in compiling the index would have to be verifiable, not based on perception, they stressed. This meant it would have to be drawn from empirical reports and/or national accounts, which could easily be verified. Countries would then be allocated a score from 1 (the worst for economic freedom) to 10 (the best), based on the distribution of the underlying data.

In 1989/90, an initial index was compiled and made available to interested parties. This assessment covered 79 countries and was based on 11 variables. Some commentators complained that the index contained too few variables. How could economic freedom be defined and measured in such scant terms? However, when people looked at which countries came out high or low on the index, its outcomes seemed to pass a general 'sniff' test.

The first edition of the index of economic freedom was published in 1996. By 2014, the index had expanded to evaluate 152 countries in terms of more than 50 variables.

The Fraser Institute came in to help in the early 1990s, and the first edition of the index of economic freedom was published in 1996. It then covered 102 countries and canvassed 17 variables. By 2014, the index had expanded to evaluate 152 countries in terms of more than 50 variables. It had also assembled data covering more than 40 years, allowing it to track trends from the early 1970s.

Five categories of economic freedom

The index has five categories, each of which incorporates various sub-categories. Its data is drawn from international reports, such as the World Development Indicators compiled by the World Bank, the International Country Risk Guide compiled by private risk analysts in the PRS Group, and the Global Competitiveness reports of the World Economic Forum and the Swiss-based Institute for Management Development.

The index has five categories. Much of its data is drawn from international reports. Scores are aggregated within each category and combined to give a single score.

The five categories are: (1) Size of Government; (2) Legal Structure and Security of Property Rights; (3) Sound Money; (4) Freedom to Trade with Foreigners; and (5) Regulation. Scores are aggregated within each category and are given equal weight when they are combined to give a single index total. In analysing the significance of these scores, commentators often assign countries to one of four quartiles, ranging from the 'most free' to the 'least free'.

Size of Government

This category looks at the extent of government spending relative to the rest of the economy. The more expenditure there is by the government, the fewer choices business or consumers are likely to have. For example, if the government dominates health-care or education, then there are fewer opportunities for entrepreneurs to explore different methods and levels of service in those spheres. Also relevant is the role of state-owned enterprises, which often have monopoly rights over energy, telecommunications and the like, thereby restricting competition and undermining the vibrancy of an economy.

Legal Structure and Security of Property Rights

This category assesses judicial independence and the impartiality of the courts, along with the extent to which property rights are protected and contracts enforced. Its emphasis, in a nutshell, is on the extent to which the rule of law is upheld.

Sound Money

This third component of the index may seem a strange bedfellow to the others, but a government's ability to manage the money supply through the actions of its central bank often leads to high and erratic rates of inflation, which distort price signals and increase business and individual risk. High levels of inflation are also a major disincentive to the savings and investment vital to economic growth, and represent an effective transfer of wealth from cash-holders (via creeping tax brackets and reduced purchasing power) to the government.

The 'Size of Government' category looks at the extent of government spending. Also relevant is the role of state-owned enterprises, which often have monopoly rights over energy, telecommunications, and the like.

Freedom to Trade with Foreigners

This fourth category covers trade barriers such as import tariffs and exchange controls. When governments raise tariffs or arbitrarily attempt to choose 'winning' industries to support with subsidies and tax incentives, they distort the business environment. Higher tariffs make goods more expensive for

consumers, while also raising input costs and eroding the competitiveness of firms wanting to penetrate export markets. Exchange controls on capital are also extremely damaging, as they encourage citizens to try to remove their capital and raise red flags to foreign investors thinking of bringing in money and skills.

Regulation
This fifth component of the index is broken down further into the sub-categories of credit (which covers issues such as the ownership of banks and the availability of private credit); labour (which deals with hiring and firing rules, plus minimum wages); and general regulation (the difficulties in registering or conducting a business, and whether bribes need to be paid to bypass officialdom).

The least free countries recorded average GDP per head of $5 200 in 2010, while the most free countries recorded close on $38 000 – almost seven times higher.

Global index outcomes over 20 years
The Fraser Institute's index of economic freedom is compiled on an annual basis, allowing comparisons of performance from one year to the next. However, 20-year trends over the period from 1990 to 2010 have also been compiled, providing a further useful overview.

Data for the two decades from 1990 to 2010 shows that gross domestic product (GDP) per head in the 'least free' countries grew at an annual average rate of 1.6% over this period. By contrast, the 'most free' grew by 3.6% on average, or more than double. Because of this difference in growth rates, the least free countries recorded average GDP per head of $5 200 in 2010, while the most free recorded close on $38 000 – almost seven times higher. Moreover, the average per capita income of the poorest 10% of people in the least free countries was $1 200, whereas in the most free countries the equivalent figure was nearly $12 000, or almost ten times as much.

Index data also shows that economic freedom helps attract investment and stimulate economic growth. In 2006, in an article published in *Kyklos*, an economics journal, Gwartney and his colleagues showed that countries with more economic freedom attract more private sector investment. They also demonstrate higher levels of economic growth per unit of investment than do less free countries. Moreover, economic freedom has a direct and positive impact on economic growth, as a one-unit increase in the freedom score generates a corresponding 1.5 percentage point improvement in the long-term rate of economic growth.

Global index outcomes in 2014
The 2014 index identifies the countries with the 'highest' level of economic freedom as: Hong Kong, Singapore, New Zealand, Switzerland, Mauritius, United Arab Emirates, Canada, Australia, Jordan and Finland. By contrast, countries with the 'lowest' levels of freedom are: Myanmar, the Democratic Republic of the Congo, Burundi, Chad, Iran, Algeria, Zimbabwe, and Argentina. Right at the bottom of the list is Venezuela.

Index data also shows that economic freedom helps attract investment and stimulate economic growth.

Venezuela is particularly interesting, as the EFF often singles it out as an important role model for South Africa. In 1990, Venezuela ranked similarly to South Africa, coming in at

56th place while South Africa was one step down in 57th position. Thereafter, however, the Venezuelan government began stepping up state controls and *dirigiste* interventions. Between 2005 and 2011, it took control of oil, gas, and gold operations, nationalised a key steel producer and two major agricultural suppliers, seized much of the cement industry, and began expropriating allegedly unproductive farms. It also took over various banks, while President Hugo Chavez vowed to nationalise any bank that failed to meet the state's lending requirements. The business environment became increasingly onerous for both domestic and international companies, though this was masked to some extent by the country's oil wealth.

In 1990, Venezuela came in at 56th place while South Africa was one step down in 57th position. Since then, nationalisation and comprehensive state controls have seen Venezuela sink to the bottom of the index, while poverty has grown.

Those involved in compiling the index quickly realised that a dramatic decline in economic freedom was taking place in Venezuela. This meant the country offered a real-life means of testing whether increased state intervention and control would in fact generate the prosperity promised by the government. Sadly for Venezuelans, the opposite occurred. Rampant inflation, corrupt governance, and economic devastation have been the main fruits of the nationalisation and other state controls implemented by Chavez. Moreover, as Venezuela has sunk to the bottom of the index, so poverty has grown.

Also particularly relevant is the performance of Hong Kong, Singapore, South Korea and Taiwan. The EFF often identifies these as countries for South Africa to emulate, claiming that these nations pursued heavily interventionist policies and reaped exceptional economic growth as a result. However, the economic freedom scores of these countries over 30 years suggest a different story.

Both Hong Kong and Singapore have led the economic freedom index for the past 30 years. South Korea and Taiwan have been in the top 30 for the same period while, in the 2014 report, Taiwan was ranked as the 18th most free country out of 152. To the extent that these nations have pursued state-led industrial policies, this has been against the background of high levels of private ownership and entrepreneurial freedom.

In the 1995 report, South Africa was ranked 46th out of 123 countries. Since then, its ranking has fallen significantly, putting it 93rd out of 152 countries in 2014.

Longer-term trends, going back as far as 1970, further illustrate this point. In 1970, countries in the bottom decile of the index had average GDP per capita of $1 182, while in 2011 the equivalent figure was $1 224, showing these countries had experienced virtually no growth at all over 40 years. However, over the same period, countries in the top decile – including Hong Kong and Singapore – went from average GDP per head of $13 384 in 1970 to $29 886 in 2011, a doubling of income between generations.

South Africa's performance since 1994

In the 1995 report, South Africa was ranked 46th out of 123 countries. Since then, however, South Africa's ranking has fallen significantly, putting it 93rd out of 152 countries in 2014.

This puts South Africa alongside the likes of Mexico, Haiti, Tanzania, and Swaziland. While South Africa still scores relatively well in the areas of judicial impartiality, private ownership of banks, and the freedom of foreigners to visit, it scores particularly badly on 'hiring and firing regulations' (142nd out of 152) as well as on 'centralised collective bargaining' (139th), 'business costs of crime' (136th) and 'government consumption spending' (123rd).

Already, diminished economic freedom has helped reduce South Africa's average growth rate since 2009 to 1.9% of GDP, while slow growth has compounded the unemployment crisis.

Government expenditure in South Africa, as a percentage of GDP, is now among the highest in the world. If increased government expenditure truly boosted economic growth, South Africa would have one of the highest growth rates in the word. Instead, high consumption spending by the state has undermined growth. Hence, growth in GDP per capita has been minimal, averaging 1.6% since 1995 and coming in at 0.6% in 2013.

Contrast this with Hong Kong's growth in GDP per capita of close to 2.6% over the same period. This difference in percentage points may not seem much, but compounding rates in fact make for very meaningful differences. At Hong Kong's growth rate, average incomes will double in 28 years. South Africa will take 44 years to achieve the same doubling.

The prognosis for South Africa

Already, diminished economic freedom in South Africa has cost the country heavily. Since 2009, the annual rate of economic growth has averaged a mere 1.9%, putting South Africa far behind many other sub-Saharan African countries significantly less well endowed with infrastructure, mineral wealth, and other resources.

Slow growth has compounded the unemployment crisis, especially among the relatively unskilled African majority. The number of unemployed South Africans, on the official definition that excludes those not actively seeking work, has thus more than doubled under the ANC's watch, rising from roughly 2m in 1994 to more than 5.2m in 2014. On the expanded definition, which counts discouraged workers, the picture is even worse, the number of jobless South Africans having risen from 3.7m in 1994 to some 8.3m in 2014. Many of the unemployed are young people aged 15 to 24, among whom the official unemployment rate is 52%. On the expanded definition, youth unemployment stands at a staggering 65%.

If South Africa embarks on the path advocated by the EFF and implicitly endorsed by the ANC, the country could drop into the 'least free' category, along with Zimbabwe and Venezuela.

At present, South Africa remains within the third quartile (one up from the 'least free' category) among the countries measured by the index. Though the heavy hand of the state has been increasing, the country still enjoys a significant measure of economic freedom. This has helped to sustain growth, albeit at low levels. It has also allowed extensive redistribution via the budget, which has greatly benefited the poor over the past 20 years.

However, if South Africa embarks upon the path advocated by the EFF and implicitly endorsed by the ANC, the country could drop into the 'least free' category within the index.

As illustrated by Zimbabwe and Venezuela, investment would then diminish while the growth rate would deteriorate, joblessness would worsen, and inflation would soar.

By contrast, if South Africa could be freed from outdated Marxist ideology and *dirigiste* state interventions, the country could start rising up the index of economic freedom. This, in turn, would lead to more investment, faster growth, additional jobs, and increased prosperity for all – including the poorest and most marginalised.

- by Neil Emerick

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