

Hayek Rediscovered: The Road to Economic Freedom

By

Surjit S. Bhalla *

June 15, 1999

Revised Final Draft: April 4, 2000

*President, Oxus Research and Investments. Paper prepared for a conference sponsored by the Mitsui Life Financial Center, University of Michigan on "Economic Freedom and Development" in Tokyo, June 17-18, 1999. I would like to thank Arindom Mookerjee and Suraj Saigal for excellent research assistance.

6 Siri Fort Road, 3rd. Floor,
New Delhi - 110049
India

Phones: (91) (11) 625-7141; 625-7142

Fax: (91) (11) 625-2117

E-mail: ssbhalla@vsnl.com

Introduction

It is indeed appropriate that a conference entitled “Economic Freedom and Development” is being held in this the 100th birth anniversary year of Friedrich Hayek. He was the originator of the idea that freedom, especially economic, was conducive to sustainable, and higher, economic growth. It is not an exaggeration to state that the developing countries would have been substantially ahead of where they are today if they had paid heed to Hayek’s fears about economic control (opposite of economic freedom) that were so eloquently expressed in The Road to Serfdom in 1944. Fifty-five years later, let us recognize our debt to Hayek. Not only did he see the future correctly, he also foresaw the *sequence* of consequences of attempts to control economic freedom.

In 1995, Robert Skidelsky wrote a book that testified to the essentially lonely battle that Hayek had fought, and eventually won. His book was entitled The Road from Serfdom. As we all re-learn from history, and especially those of us from mixed economies (most of the developing world), we need to chart a “new” economic future. This future must, does, include large doses of economic freedom.

Inevitably, the discussion of economic freedom centers around the topic of the role of the state. *That* is a much larger issue. Nevertheless, this paper contends that the principles of economic freedom dictate that there should be a separation of the role of the state as a *financier*, from the role of the state as a *producer*. This distinction is critical, and it is suggested that if past policy makers had kept this distinction in mind, the policy mistakes, and the consequences of low economic freedom, would have been that much less. The most important exposition of this idea was by Milton Friedman in his book *Capitalism and Freedom*.¹ As early as 1962, Friedman advocated the use of a voucher system for education services; this system combined the role of financing externalities, and the efficiencies of “competitive capitalism”. While the discussion at

¹ It is interesting to note the different views on freedom between Hayek and Friedman. For Hayek, freedom was an absolute; societies which pursued this absolute would inevitably be led to the operation of free markets. For Friedman, the operation of free markets was the goal, an end in itself.

that time was with respect to education, the logic of vouchers can easily be extended to other social sectors like health, etc.

The East Asian crisis of 1997 changed a few equations, and brought the concept of economic freedom (or less state control) into doubt – yet again. At the peak of the crisis, late December 1997, there were demands for capital controls, for international and domestic bureaucrats to control the excesses of private capitalism. The movement for capital controls etc. was led by leading Western economists; the history of the last fifty years is replete with examples of do-gooder liberals transferring their (white man's) burden onto the shoulders of unsuspecting natives. On this occasion, several natives rebelled; i.e. the *objections* to capital controls came from developing countries themselves. While policy is (still) being formulated by (mostly) Western economists for the consumption by developing countries, the recipients of this advice are broadly *not* in favor of reliving the past. Regardless of the ideology, it is still a relevant question to ask about the effectiveness of Malaysian capital controls.

The paper is organized as follows. Section 2 discusses the evolution of thought on economic freedom, a mid-twentieth century idea first mooted by Hayek. Section 3 discusses the problems involved in the *definition* and *measurement* of economic freedom. Section 4 presents empirical estimates on the relationship between economic freedom and growth. Section 5 discusses the new threat to economic freedom, capital controls, and evaluates how Malaysia has performed emerging from the financial crisis in comparison to its neighbors who have *not* imposed capital controls. Section 6 concludes.

Section 2: **History of thought on economic freedom:**

The concept of economic freedom is a relatively new one. Prior to the communist takeover of Russia in 1917, economists concerned with market distortions concentrated on problems caused by monopolies, trade protection etc. But the practice of communism, and the emergence of economic depression in the thirties, changed the rules of the game for the rest of the twentieth century.

The depression caused a new “externality” to appear on the economists menu – that of comprehensive market failure. This gave birth to Keynesism – the view that market failure could only be rectified by much greater government involvement in the economy. And involvement came not from the operation of foreign policy, or the conduct of war and peace or the operation of law and order (the natural roles of government), but rather from deficits in the government budget!

The increase in government action in economic affairs meant a symmetric decline in economic freedom. This was a necessary, and inevitable, “trade-off” between more individual freedom and more government action. For example, whether price-controls were imposed due to the exigencies of wars, or due to the demands of redistributing income according to a social welfare function, or due to a desire to contain inflation, government policy meant a restraint on individual “market” action.

The implementation of minimum wages legislation and foreign exchange controls on domestic residents is also a restraint on individual freedom. In developing countries, greater government involvement meant more government production of *all* goods - from cement to condoms to computers. The logic of government action e.g. involvement when significant externalities were present, got lost in the race towards greater government action for the greater good of the people. It was precisely the elimination of the distinction between legitimate and “illegitimate” government action which led to significant differences being observed in the economic freedom being provided to citizens of different countries.

And it was this overarching state that Hayek had warned about in 1944; and he continued to lament against the “New World Order” throughout the post-World War II period. The expansion of government action meant a new market distortion – hence, the need for economists to define and consider the role of economic freedom in determining productivity differences. A first approximation to the definition could be as follows: economic freedom is whatever was taken away from individuals in order that the objectives underlying the government’s social welfare function can be achieved.²

The new objective of avoiding collective market failure – and especially of the economic depression variety – obviously met with universal approval. That the deduced policies were of the *loco parentis* variety was more an outcome of the intellectual climate of the times rather than of logic. Since the mid-nineteenth century, several philosophers and economists had battled with what was correctly perceived to be *the* problem with market economics – that income distribution maybe, could be, always will be different than that market participants, and society at large, desired *ex ante*. How could this “distortion” be corrected? Two broad approaches were possible – either all the means of production were to be owned by the state, and then redistributed according to a social welfare function (Communism), or rich individuals could be taxed to finance the income levels of the poor (democratic socialism). A progressive income tax rate was a manifestation of this desire to redistribute income in the most socially efficient manner.

But democratic socialism was not able to avoid economic depression in the countries where the ideal of freedom, and democracy, was accepted the most. The appeal of Communism was there in the West but not the desire to give up freedom. Thus, the response to the depression was broadly along democratic lines i.e. a greater role for the government in managing the economic affairs of the citizens. It was democratic because governments could be changed if the policies were deemed “wrong” – something not possible under Communism. The decline in economic freedom which accompanied this greater role was considered unimportant – indeed, negligible.

² See Bhalla(1992,1994) for one of the first attempts to define economic freedom after the pioneering contributions of Hayek and Friedman.

Except for Hayek, who wrote about the emerging dangers of “totalitarian democratic socialism” in his major philosophical work, *The Road to Serfdom*. In this book, Hayek examined the logical basis of totalitarianism and democratic socialism and found them identical! He then surmised that governments would accrue more and more power to themselves and over time would approach the totalitarian state. For this he was vilified, and ignored. But fifty-five years later, it is Hayek whose forecasts have turned out to be right, for both developed and developing countries.

It was this book that first defined economic freedom, and outlined the consequences for the polity when such freedoms were decreased, or removed. The following quotes from the book are relevant:

On the logical similarity between totalitarianism and democratic socialism:

“Conditions in England and the United States are still so remote from those witnessed in recent years in Germany as to make it difficult to believe that we are moving in the same direction.....There exists now in these countries certainly the same determination that the organization of the nation which has been achieved for purposes of defense shall be retained for the purposes of creation.....many who think themselves infinitely superior to the aberrations of naziism, and sincerely hate all its manifestations, work at the same time for ideals whose realization would lead straight to the abhorred tyranny. (pp.2-4).

On how prior to the thirties the political and economic world had evolved: “During the whole of this modern period of European history the general direction of social development was one of freeing the individual from the ties which had bound him to the customary or prescribed ways in the pursuit of his ordinary activities....The subsequent elaboration of a consistent argument in favor of *economic freedom* was the outcome of a free growth of economic activity which had been the undersigned and unforeseen by-product of political freedom”. (pp. 15, italics added).

On the necessary role of the state: “The liberal argument is in favor of making the best possible use of the forces of competition as a means of co-ordinating human efforts, not an argument for leaving things just as they are...The functioning of competition not only requires adequate organization of certain institutions like money, markets, and channels of information – some of which can never be adequately provided by private enterprise – but it depends, above all, on the existence of an appropriate legal system, a legal system designed both to preserve competition and to make it operate as beneficially as possible” (pp. 36-38). Also, “there can be no doubt that some minimum of food, shelter, and clothing, sufficient to preserve health and the capacity to work, can be assured to everybody...the case for the state’s helping to organize a comprehensive system of social insurance is very strong” (pp. 121)

On the definition of economic freedom: “It is necessary in the first instance that the parties in the market should be free to sell and buy at any price at which they can find a partner to the transaction and that anybody should be free to produce, sell, and buy anything that may be produced or sold at all. And it is essential that the entry into the different trades should be open to all on equal terms and that the law should not tolerate any attempts by individuals or groups to restrict this entry by open or concealed force. Any attempt to control prices or quantities of particular commodities deprives competition of its power of bringing about an effective co-ordination of individual efforts, because price changes then cease to register all the relevant changes in circumstances and no longer provide a reliable guide for the individual’s actions” (pp. 37).

On the dangers of economic control: “ *The extent of control over all life that economic control confers is nowhere better illustrated than in the field of foreign exchanges.* Nothing would at first seem to affect private life *less* than a state control of the dealings in foreign exchange, and most people will regard its introduction with complete indifference. Yet the experience of most Continental countries has taught thoughtful people to regard this step as the decisive advance on the path to totalitarianism and the suppression of individual liberty. It is, in fact, the complete delivery of the individual to the tyranny of the state, the final suppression of all means of escape – not merely for the rich, but for everybody. Once the individual is no longer free to travel, no longer free to buy foreign books or journals, once all the means of foreign contact can be restricted to those of whom official opinion approves or for whom it is regarded as necessary, the effective control of opinion is much greater than that ever exercised by any of the absolutist governments of the seventeenth and eighteenth centuries.” (p. 92, italics added).

On the trade-off between economic freedom and a “desired” distribution of income: economic planning is advocated not “because of its superior productivity but because it will enable us to secure a more just and equitable distribution of wealth. It is indisputable that if we want to secure a distribution of wealth which conforms to some predetermined standard, if we want consciously to decide who is to have what, we must plan the whole economic system. But the question remains whether the price we should have to pay for the realization of somebody’s ideal of justice is not bound to be more discontent and more oppression than was ever caused by the much-abused free play of economic forces.” (pp. 99)

On the co-existence of political and economic freedom: “It is often said that political freedom is meaningless without economic freedom. This is true enough, but in a sense almost opposite from that in which the phrase is used by our planners. The economic freedom which is the prerequisite of any other freedom cannot be the freedom from economic care which the socialists promise us and which can be obtained only by relieving the individual at the same time of the necessity and of the power of choice; it must be the freedom of our economic activity which, with the right of choice, inevitably also carries the risk and the responsibility of that right”. (pp. 100)

The reason Hayek has been quoted in elaborate detail above is to emphasize that he both outlined the threat to economic (and political) freedom from democratic socialism, and the likely consequences (decline in growth, productivity and freedom) as early as

1944. He asserted/forecast a very strong positive relationship between economic freedom and economic development . No empirical estimates were provided by Hayek because this was before the future had happened! Section 4 of this paper does attempt to provide empirical validity to the Hayekian hypotheses.

In a few short years after World War II, the world order changed. Several developing countries achieved independence and looked for guidance towards the West and the East. In the West, government planned reconstruction had achieved wonders – the European economies were enjoying unprecedented economic growth with increasingly large doses of government involvement in economic activity. Economic depression became a distant memory, and it seemed that *some* planning was extremely productive. Some European countries – and particularly those with a strong left tradition like England – extended enormously the role of the government.

This then was the international intellectual and economic environment that developing countries faced as they emerged from former colonial rule. With their erstwhile colonial masters choosing a strong role for the state, it was unlikely that the new countries would follow Hayek. The original purpose of increased government intervention - avoidance of severe economic macro-economic contraction – was lost in the assumed superiority of government in handling *all* economic activities. Planning became the norm, and bigger planning meant a better future. Western economists also purported to show the duality/equality between a market, individual system and a government/central planning system. This theoretical equivalence ignored all of the political dangers pointed out by Hayek.

The role of planning became more than conventional wisdom – it became universal. Two voices in the wilderness were important – Bauer and Friedman. In his book *Capitalism and Freedom*, Friedman talked about issues in an analogous fashion to Hayek. Friedman suggested that economic freedom was a goal in itself, and indeed might be a necessary condition for political freedom. He did not discuss the consequences of lower productivity growth from economic control, an issue of seemingly greater concern to Hayek. Friedman also was more optimistic about the benefits of political freedom. “Historical evidence speaks with a single voice on the

relation between political freedom and a free market. I know of no example in time or place of a society that has been marked by a large measure of political freedom, and that has not also used something comparable to a free market to organize the bulk of economic activity". (1962, p.9) India was to prove Friedman radically wrong, as its planners proceeded to assume draconian controls over economic activity within an essentially free political system. ³

However, Friedman's important study was to be the last warning before truly mega-planning of most of the developing, and several of the developed economies. (The US escaped the worst excesses). So isolated were the forces of liberalism – Hayek, Friedman and Bauer – that what they taught, and advocated, did not make even the reading lists of important American universities. So universal was the hold of democratic socialism and/or planning that the phrase "economic freedom" and/or "economic liberties" is not to be found in most (or any) economic literature published between 1962 and 1988. The lack of *any* discussion of economic freedom by economists, and the considerable political science and economic literature on political freedom (see Bhalla(1992, 1994) for a sampling) only emphasizes the stranglehold of prevailing "liberal" economic opinion. Discussion of political freedom was politically correct – discussion of economic freedom was politically incorrect. Eastern universities (and I can vouch for Princeton in the early seventies) did not even mention Hayek let alone study his prescient analysis of economic freedom and growth; and Friedman was mentioned only for his views on monetarism and for his "battle" with fiscalism.

Notably, the discussion, then, and even today, on fiscalism was *not* on the role of economic freedom but rather on the intricacies of "macro-economics". Larger goal of macro-economic stability seemed to be worthwhile for the smaller sacrifice of some freedoms. And nothing succeeds like success for the politicians and other masters of the state - the denial of freedom accelerated and became the recommended policy. And international development institutions like the World Bank and the International Monetary Fund (IMF) followed suit, if not led the advocacy.

³ There is a not apocryphal story about a senior policy maker, when asked about the reasoning behind some highly unreasonable financial market controls, stated "If you ask for logic, we will

Perhaps co-incidentally, and poetically, the politicians (*not* economists) were the first to lead the attack on the denial of economic freedoms, or the larger than life role of the state. First, Margaret Thatcher, and soon to be followed by Ronald Reagan. After decades in the wilderness, Hayek was resurrected. It became politically correct for economists to question the role of the state. After a quarter century gap (since Friedman in 1962), the *first* economist to re-outline, and provide empirical estimates, of the Hayekian thesis was Scully (1988). This research was followed up in a subsequent article in 1991 by Scully (with Slottje). In these two articles empirical estimates of the positive relationship between economic freedom and economic growth were presented. As reported by Grubel(1998), the Mount Pelerin Society did suggest a study of economic freedom and development as early as 1984; published research emanating from this concern did not appear till the mid-nineties.

Simultaneous with Scully-Slottje (1991) were attempts towards a more rigorous definition, and estimation, of the relationship between economic freedom and growth. The World Bank emphasized this aspect, albeit indirectly, in its World Development Report 1991, entitled *The Challenge of Development*. This research was followed by Bhalla (1992,1994).⁴

Bhalla was also the first to estimate the *separate* effects of political and economic freedom on economic growth. This separation turned out to be critical in simultaneously explaining the reasonable levels of growth rates of democratic (political freedom) countries like India, Sri Lanka, Costa Rica etc. in comparison to low-growth authoritarian economies in Latin America and Africa (time-period of analysis 1973-1990); as well as in explaining the poor performance of these economies with respect to East Asia (low political freedom but relatively high economic freedom). Note that in the early nineties, the Singapore Prime Minister Lee Kwan Yew was the “guru”; he contended that authoritarianism was necessary for successful economic development

not help you!”

⁴ Interestingly, Bhalla’s analysis was criticized by economists and bureaucrats at the World Bank and the criticism was reflected in the fact that the paper was not deemed worthy of “publication” in the *non-refereed* World Bank *Working Paper* series! The 1992 article also grated on World Bank sensitivities regarding China’s lack of political freedom and the fact that China’s income levels over the years were not consistent with published figures for GDP growth.

and that the reason that democratic countries like India had lagged behind in per capita economic growth was because India was, well, democratic. The authoritarian high growth correlation was too strong to ignore for politicians and experts like Wade (1990) and the “Economist”. Bhalla (1992) showed that the authoritarian regime-high growth correlation was not only spurious but wrong; further, that *both* political and economic freedom contributed positively to higher productivity growth.

There are problems in estimating a relationship between freedom and economic growth. It is highly likely that freedom and growth go hand in hand i.e. are simultaneously determined. Lipset argued as early as 1959 that richer countries would want higher political freedom – so a positive relationship between growth and political freedom would be observed. There are fewer simultaneity problems with regard to economic freedom; bad policies are not just the preserve of poor countries.

While it is important to control for simultaneity, one should not exaggerate its relevance. Investment is an important determinant of growth, and vice-versa, yet very few economists would suggest that a relationship between growth and investment was not meaningful. Ditto for a relationship between savings and growth; or savings and investment. The problem with most of the macro variables is that it is difficult, if not impossible, to find an “identifying” variable; i.e. a variable which affects output (e.g. growth) and not inputs (e.g. investment).

There is one possible variable which can be used to identify a growth-freedom regression – colonial heritage i.e. controlling for the colonizing country (including always independent economies). Colonial heritage is likely to have been an important factor in the development of political institutions e.g. countries colonized by England are likely to have a greater desire, *ceteris paribus*, for political freedom than countries colonized by France or Spain. Bhalla(1992,1994) uses a colonial heritage variable to identify the political freedom equation. Thus, the relationship between political freedom, economic freedom and productivity growth was estimated by Bhalla within a rigorous statistical framework.⁵

⁵ Bhalla's innovation of the use of the colonial heritage variable was (implicitly) endorsed by Robert Barro in his treatise *Determinants of Economic Growth* published in 1997. Barro (without

In this paper, a somewhat different approach is offered. Researchers generally estimate regressions in a level-level form i.e. the *level* of economic growth during a particular period (e.g. 1973-1997) is related to the *level* of investment share (and other variables). If there is a constant third factor affecting both these variables, then that suggests need for an “identification” variable. However, if the equation between growth and investment is estimated in change-change form (i.e. change in growth rate as a function of the change in investment share from one period to the next) then the effects of the common, but unmeasured, third fixed factor are factored out. (See next Section).

This present paper is about Hayek rediscovered. The entire last decade has in fact been a celebration of Hayek. Countries around the world have moved towards more and more political liberty. Developing countries i.e. countries for whom greater economic growth is a *necessity*, have hurried towards implementing “economic reforms”. While some of them are hesitant to admit it openly (in some circles, even today, Hayek is deemed politically incorrect), in corridors of power Hayek is the new guru – and the road to economic freedom the politically, and economically, correct highway. Economists have also not lagged behind – the literature on economic freedom is now a growth industry. Organizations are vying with each other to bring out indices of economic freedom, and researchers are attempting to establish that there is a profound, and necessary, relationship between economic freedom and economic growth.

The above has been a review of the history of thought on the importance of economic freedom *per se*. While not explicitly mentioning the Hayekian notion of economic freedom, various analyses of the consequences of the denial of such freedoms have appeared in the literature. Bhagwati-Desai (1970) were among the first, if not the first, and certainly the most painstakingly exhaustive, of the volumes appearing on the evils of planning. It was also there before the trend; indeed, Bhagwati-Desai might have helped define the emerging new conventional wisdom on the evils of “democratic socialism”. NBER volumes on the effects of trade distortions, as well as the series of

attribution!) also uses the colonial heritage variable to “identify” his simultaneous model regressions.

studies conducted by the World Bank under the guidance of Anne Krueger, can all be construed as documenting the case for economic freedom. These large volume studies make trivial any attempt to measure the effects of economic freedom via cross-section time-series relationships as done in Bhalla(1992,1994,1997), and this paper. The advantage of the latter studies is that they attempt to make explicit the relationship between economic freedom and growth – and provide “broad” estimates of lost growth due to lost freedom. The next two sections are devoted to a discussion of the definition, and measurement of economic freedom and its relationship to growth and productivity.

Section 3: **Definition and Measurement of Economic Freedom**

As discussed in the previous section, the first economist to be explicitly concerned about economic freedom was Hayek, and he was also the first to formally define the term. The discussion below summarizes, and interpolates, his definition, an exercise previously conducted in Bhalla(1992). Essentially, the presence of economic freedom means the presence of rights provided by a free and competitive environment e.g. the provision of property rights, external and internal openness (right to buy and sell goods to whomever one wishes and at prices the competitive market determines); rights to set up investments without a license, rights to foreign travel, rights to hire and fire (with due process); rights of domestic and international movement of labor and capital etc.

Omitting the freedom to immigrate, labor freedom means the right to work anywhere in national boundaries and at wages the impersonal market determines, rather than the "face-less" bureaucrat. Capital freedom means the freedom to obtain the highest return on one's capital either domestically or abroad -hence, negative real rates of interest domestically would suggest a need for freedom to transfer one's capital abroad. Produce freedom implies a right to sell abroad at favorable prices, or to import from abroad if import products are cheaper.

The above broad definitions suggest several variables which can be used to capture components of economic freedom e.g. nature of property rights (land ownership, urban land ceilings, patent rights etc.), high trade taxes, unionization, licensing procedures, capital market controls, minimum wages etc. Each constraint on market behavior (excepting that of

monopolists and actions that ignore externalities) constitutes an infringement of economic freedom.

Today, economic freedom is another growth industry with Freedom House (pioneers of research on political freedom indices), Heritage Foundation and Fraser Institute (along with CATO, IEA and other collaborators) all developing and publishing economic freedom indices for a large cross-section of countries. Both the Heritage Foundation and Freedom House surveys are important additions to the literature. Over time, the Freedom House data is likely to rival the brilliance of the political and civil rights data conducted by that organization since the early seventies; for the present, only a snapshot for 1994-95 is available and hence is of limited use.

While Gwartney-Lawson (1997) (hereafter referred to as GL) are to be commended for assembling a rich body of data (Fraser Institute data), problems remain with their “overall” index of economic freedom. This is because this index, as outlined below, includes several variables which capture reality outside of, or in addition to, economic freedom.⁶ While the index, and its components, is constantly being revised, the discussion below relates to the draft released in 1998 and containing estimates for economic freedom in 1997.

The guiding principle for inclusion/exclusion of a variable as an economic freedom/policy variable is whether such a variable is *exogenous* to GDP growth. For example, for GL, monetary policy and price stability (essentially money supply growth and inflation) are important components of freedom. Inflation, especially runaway inflation, is bad for the citizenry, and bad for growth. But it has precious little to do with freedom. However, if a country has controls on capital flows, which prevent citizens from avoiding or arbitraging domestic price instability, then price inflation (or money supply growth) can capture portions of economic freedom in addition to portions of economic instability. If inflation has an effect in dampening growth, and if higher inflation means lower freedom, then a spurious relationship between growth and economic freedom can result.

Scully-Slottje(1991), World Bank (1991) and Bhalla(1992) were the first to underline the importance of the use of black market premium (BMP) as a variable which effectively captured the freedom, or lack thereof, to transfer money. This variable also had the advantage of being advocated by Hayek (see the quote by him regarding the pernicious nature of foreign exchange controls in Section 2). But as Rodrik(1998) has pointed out, BMP also captures macro-economic instability. For example, if inflation increases in the presence of foreign exchange controls, the premium on the foreign stable currency is likely to go up *without any increase in foreign controls*.

Among the genuinely exogenous, and genuinely freedom, variables tabulated by GL are the following: price controls, freedom to use alternate currencies, legal structure and property rights, international exchange (mean tariff rates, non-tariff restrictions etc.), and capital and financial markets (interest rate controls, capital transaction restrictions). Unfortunately, a representative time-series data for the above variables is only available (at present) for 13 developing countries i.e. too small a sample from which to derive generalizations.

Econometric Analysis: Important Variables :

The dependent variable is growth in per capita income (in constant dollar, 1995 prices). This variable is an approximation to productivity growth, especially growth in labor productivity. The time-period of analysis is from 1970 to 1997.

Even if seemingly exogenous variables are used (e.g. price controls, high import tariff rates etc.) it can be argued that some, or all, of these variables are contaminated by the presence (or absence) of price instability. Consequently, all the regressions reported contain an inflation “control” variable.

In addition to inflation, there is another equally important, control variable – the share of investment in GDP. This is, not surprisingly, one of the most important determinants of GDP. If a variable is significant in the presence of an investment/GDP variable, then it

⁶ This problem arises with all the published economic freedom indices; the comments pertain to the Fraser Institute data because their data are the richest, and they have the least problems of

can be considered to be robust to alternative specifications. It is also common, and correct, to control for initial levels of income in order to properly account for catch-up. In a capital and technology mobile world, late-comers have an advantage in that they have low labor costs, and can proceed rapidly to international technology levels. During the transition stage, economic and productivity growth in these economies will be higher than that predicted by other factors like investment. The initial level of income variable captures this catch-up.

In addition to the above three “basic” variables (dependent variable, per capita GDP growth; independent variables, initial level of income and share of investment in GDP), five other variables are used: inflation (measured by GDP deflator), fiscal deficit as a proportion of GDP, black market premium on currency, the real interest rate received in savings deposits, and the Freedom House index for political and civil liberties.⁷

Fiscal Deficit – Fiscal Deficit as a share of GDP reflects both macro-economic considerations and economic freedom. However, the economic freedom component is negligible for open economies. In an open economy, operation of fiscal deficits (or surpluses) do not affect economic freedom because citizens can move their capital across borders. In a closed economy, large fiscal deficits and their onerous effects (high cost of capital) affect the operation of enterprise and are therefore indicative of less economic freedom.

Indices for inflation, black market premium and real interest rates:

These three variables can be introduced into an equation either in their original form, or transformed into an index. In the former case, an economy with an average inflation rate of 2 percent will be considered “twice” as good as an economy with 4 percent inflation, and 10 times “better” than an economy with 20 % inflation. Raw levels have problems of outlier values, and also problems of linearity. It is highly likely that a 4 percent inflation rate is really not twice as worse as a 2 percent rate, and a 20 percent

definition.

⁷ Freedom House has published political and civil liberties indices for several countries since 1973. Countries are ranked from 1 (most free) to 7 (least free). Not surprisingly, there is a high degree of correlation between the two components. Consequently, an average of the two indices is taken to represent “political and civil liberties”. Further, the indices have been “reversed” to reflect higher freedom with a higher value i.e. 1 represents least freedom, and 7 the most.

inflation rate is not more than twice as worse as a 10 percent rate. One method of introducing non-linearities is by assigning index values according to the *distribution* of inflation rates observed since 1973 for all countries. This distribution is then used to assign index values. (See Appendix I for details of construction of all the indices).

Index for political and civil liberties: This variable was used to capture political freedom in World Bank(19910 and Bhalla(1992,1994), and is also the variable used by most researchers.

Section 4: **Estimating the relationship between growth and economic freedom**

In its most general form, the model relating productivity growth to freedom is as follows:

$$(1) \quad Y = f(X_1, X_2, F; Z)$$

where Y is productivity growth (represented by per capita growth in GDP), X_1 is a vector of non-fixed “control variables, X_2 a vector of non-fixed variables which can affect Y and have an economic freedom component, F represents freedom variables (both economic and political) and Z represents unobservable fixed factors that are specific to each country.

The normal procedure is to estimate equation (1) for a group of countries where each variable refers to the average observed over the time-period. The results of this exercise are reported in Table 1c where the averages are for the period 1973 to 1997 (1973 is the first year for which data were available for political and civil liberties). This form of a regression, while useful, suffers from the drawback that it does not account for the possibility that Y and F are simultaneously affected by some unknown fixed factor Z.

If Equation (1) is rewritten in first-difference form one obtains:

$$(2) \quad dY = f(dX_1, dX_2, F \text{ or } dF)$$

where d is the first-difference operator. Note several points about equation (2) – first, the variable being explained is the change or *acceleration* in per-capita income growth, a variable likely to be a lot more “noisy” than per-capita income growth. Second, such an exercise cannot be undertaken for one-period data as in equation (1). Third, the unobserved fixed effects are factored out and are no longer contaminating the estimation. Fourth, F can be inserted in either level form (the absolute level of freedom matters more than the change in such freedom) or in change form (acceleration in growth is not a function of the level of freedom but only of the change in such freedom).

Whether F or dF is used is a matter of empirical choice; results for the two models are reported in Table I(a) and I(d) (change-change) respectively.

Both initial level of income and investment share are entered as first differences in equation 2. The choice is unclear for fiscal deficit i.e. is a change in fiscal deficit more relevant for growth than its level? Phrased differently, will a country grow at a faster rate if the fiscal deficit changes from -15% to -10% than a country which maintains a low fiscal deficit to GDP ratio of around -3% ? Empirically, the level is more significant than the change; hence, this is the variable used in the change-level regressions reported in the most preferred model, Table I(a).

Results:

The results for four different sets of regressions are reported in Tables 1a-1d. What is remarkable is that regardless of the method or specification (levels or first differences or a mixture), the results are extremely robust. The discussion below pertains to the coefficients observed in the regressions reported in Table 1a, and for model 4 i.e. the complete model without regional dummies.

Control Variable – Investment/GDP: The coefficient is always significant, and magnitude varies in a narrow range of 0.12 to 0.20 for the various specifications. A coefficient of 0.19 implies that a country has to increase its investment share by 5 percent to achieve a consistently 1 percent higher growth rate.

Fiscal Deficit/GDP: This variable emerges highly significant in all models. No matter what other variables (including regional dummies) and *after* controlling for the level of investment, a lower fiscal deficit means higher growth. A change of 5 percent in the share of deficit to GDP (i.e. a move from -10% to -5%) implies an increase in GDP growth of 0.75 percent.

Inflation Index: This variable is usually not significant.

Black Market Premium on Currency: This is a “pure” economic freedom variable and is significant with a coefficient of 0.16. In other words, capital controls hurt economic growth, a conclusion also supported by examination of the Malaysian experience. A

movement of 6 points in the index (e.g. a decline in BMP from 16 percent to less than 1 percent) means an increase in growth of 0.8 percent.

Note that the significance of BMP occurs in the presence of an inflation variable. Rodrik(1997) had contended that the BMP variable was spuriously reflecting the negative effect of higher inflation economies; the results in Table 1, and various specifications of equations (1) and (2) shows that when the effects of both inflation and BMP are estimated together, it is the inflation variable that is insignificant and the BMP variable that is significant i.e. capital controls have a significant, and negative effect on productivity growth. This result contradicts the result obtained by Rodrik(1998).

Real interest rates on savings deposits: In a world of free capital flows, real interest rates on all instruments should equalize across borders. If differences are observed, they are due to government controls on capital both within borders, and across borders i.e. arbitrage, and therefore economic freedom of individuals, is prohibited. This distortion was first talked about by McKinnon in the early seventies in the context of low, and even negative, real rates of interest. This was called financial repression. It is equally likely (though ultimately it is an empirical question) that too high real interest rates also constitute financial repression.⁸ For the last few years, real deposit rates in India have averaged over 6 percent, with lending rates about 2 to 3 percentage points higher. Does a country pay a price for this kind of financial repression ?

According to the results in Table 1a, (and most other models reported), each 1 point of financial repression leads to a decline in GDP growth of 0.27 percent. As discussed in the Appendix, the index of real rates is modeled in a non-linear fashion with the highest index level (10) being the mean level of real deposit rates between 1.3 and 2 percent. (In other words, the 45th to 55th percentile of real deposit rates observed in over 60 developing countries for over 25 years ranges between 1.3 and 2 percent). After this median level, each decile with higher interest rates is considered better than a decile with lower rates i.e. the 55-65 percentile gets an index value of 9 (rates between 2 and 3.5) and the 35-45 percentile gets an index value of 8 (rates between -0.1 and 1.3

⁸ Since long-term behavior is being talked about, and estimated, temporarily high interest rates during crises does not constitute financial repression.

percent). Over 50 percent of the observations have an index below 5 – if these economies were to provide freedom of capital movement to their citizens, a very large increase in growth is observed. Just a five point move in the index (or real interest rates between 0.1 and 5 percent) will yield an increase in annual per capita income growth of 1.5 percent. Given the non-linear nature, a specific example will help. Presently, term deposit rates in India are the highest in the world, at around 9 percent (or an index level of 3). If such rates were to decline to civilized levels of 2 to 3.5 percent (index level of 9), this would enable India to grow at an *extra* rate of 1.62 percent per annum!

Note that the equation has been estimated with investment share and fiscal deficit already in the equation. The “crowding out” effect attributed to fiscal deficits has already been accounted for.

Political and Civil Liberties: This variable is strongly significant with a magnitude of 0.27 in Table Ia, model 4. This significance carries through to the other models, though it diminishes somewhat in the presence of regional dummies (as expected). Again, given all the other variables in the equation, the independent effect of political freedom on economic freedom is surprisingly large. A movement from a relatively unfree regime (index value of 2) to a relatively free political regime (index value of 5) can raise output growth by almost 1 percent per annum. In this competitive world, those are large gains.

A clear conclusion that follows from the empirical analyses is that one of the surest ways of increasing long-term growth rate in developing countries is to increase economic freedom; more specifically, to liberalize the capital markets. This is in stark contrast to the recently politically correct (and economically wrong) calls for more capital controls, an issue examined explicitly in the next section.

Section 5: **Malaysia's Capital Controls: Did they Work?**

The eighties and nineties have been remarkable in terms of the observed increase in political, and economic freedom. However, since the advent of the East Asian financial crisis in 1997, the world is again on the verge of looking backward. The new *loco parentis* buzzword is capital controls – the international and domestic bureaucrats are there to prevent private citizens from losing their senses, and their wealth. This is an eerie replay of the discussion of the thirties, forties, fifties and sixties. The demands for a “new financial architecture” is a not unsubtle threat to economic freedom. Will the implementation of economic controls be a small price to pay for the presumed success of stable growth?

Fortunately, this is not just a theoretical question; in September 1998, Malaysia provided the world with a perfect laboratory experiment. It implemented capital controls in order to emerge from the financial crisis that had engulfed it, and its South-East Asian neighbors, in almost identical fashion. How well has Malaysia done, with capital controls, in contrast to the neighbors, who operated without capital controls? This issue is likely to be discussed with increasing frequency over the next few months. Section 5 provides the first attempt at analyzing the comparative evidence.

The World Bank has argued that capital account convertibility greatly exacerbated the situation, allowing capital to fly out just as freely as it had earlier flown in. Malaysia, however, imposed capital controls and pegged the ringgit within a year of the crisis. The country's performance relative to other emerging markets, and especially with the crisis countries, yields important results. One would expect, following the “capital controls” school of thought, that controls would help to pull up growth and industrial production, and to prevent the import of inflation. Yet exactly the opposite is true in Malaysia's case.

How does one compare performance across countries and across time? By “ranking” each country (“best” performance first, “worst” performance last) in terms of several macro indicators, at two distinct points: before the crisis hit **any** country (i.e., June,

1997), and at present (plenty of time to gain lost ground). For each indicator, estimates of **relative** performance at both points in time are computed. (If a country ranks last in GDP growth at both times, its relative performance has not changed.) Comparing the country's "ranks" then-and-now, with respect to East Asian and Latin American countries, Malaysia's performance comes out looking poor – a sign that capital controls have little positive impact on macro-economic performance, and may indeed cause greater harm than good. Malaysia's story might one day prove a good case study **against** capital controls.

Pre-crisis, Malaysia enjoyed the third highest GDP growth rate in relation to 11 other countries; now it stands eleventh. Its place in the inflation rankings has dropped from 4th lowest to 7th lowest. Further, Malaysian stocks have shown the lowest returns in local currency terms, and the second-lowest in dollar terms. It has seen the 3rd smallest currency appreciation (due in large part to its pegged rate), and its real short term interest rates have shown a small relative decline. Interestingly, its trade balance as a share of GDP is at present the lowest among the 12 countries considered.

Capital Controls in Malaysia: Have they Worked?

	GDP Growth		Industrial Production		CPI Inflation		Stock Market Returns			Decline in Real S-Term Interest Rates
	June, 1997	Latest	June, 1997	Latest	June, 1997	Latest	LC	\$	Currency Appreciation	
Malaysia	3	11	4	4	4	7	12	11	10	4
Hong Kong	5	10	11	12	10	1	7	2	1	.
Indonesia	6	12	1	10	7	12	10	12	12	1
Korea	8	9	7	1	5	5	2	4	7	3
Philippines	11	7	8	8	8	10	6	10	8	.
Singapore	2	5	12	3	3	3	5	3	6	6
Taiwan	9	1	9	2	2	4	8	6	5	.
Thailand	7	3	6	5	6	6	4	8	9	5
Argentina	4	4	3	11	1	2	11	5	1	7
Brazil	12	6	5	7	11	8	3	9	11	.
Chile	10	8	10	9	9	9	9	7	3	.
Mexico	1	2	2	6	12	11	1	1	4	2

Source: O[x]us Research & Investments Database.

Notes:

1. Ranks represent a comparison between countries' performances with respect to each indicator considered.

Section 6: Conclusions

The developing countries have come a long way from the de rigiste regimes of just a decade ago. Indeed, the capital market and internet revolution are pointers towards a more democratic future. While wealth and all the fortunes it brings is largely inherited, ideas are not. And if the costs of implementing one's ideas decline considerably (as they have), then freedom to think, and act, can be an important source of capital for an economy.

This paper has attempted to document the history of thought on freedom and development. Most of the leading economists of the twentieth century come out, on analysis, as being on the wrong side of history. These economists believed, and advised others to believe, that a few elites often did know better than an impersonal and democratic market; that while there was misuse everywhere, the bad products of bad capitalism were infinitely worse than the bad advice of bad economists.

Apart from theoretical, and philosophical, evidence provided by Hayek and Friedman on the positive role of freedom towards enhancing development, this paper assembles data on a wide range of economic and freedom variables, and provides estimates of the relationship between them. The results are robust, and unanimous – both political and economic freedom are significant contributors to higher economic growth. The implication for policy is obvious – provide freedom, and ye shall inherit the future.

Table I(b)**Dependent Variable: *Level*** of Per Capita Income Growth**Data:** Developing Country 5-year data from 1968 to 1997, centered on 1970,1975,1980 etc.

Independent Variables	Models				
	1	2	3	4	5
Constant	-2.84 (-2.55)	-1.81 (-1.49)	0.07 (0.05)	-1.47 (-1.25)	0.29 (0.21)
<i>Level of.</i>					
Initial Income	0.05 (0.31)	-0.04 (-0.24)	-0.41 (-1.91)	-0.49 (-2.58)	-0.73 (-3.11)
Investment /GDP	0.18 (7.37)	0.16 (6.52)	0.12 (5.06)	0.14 (5.96)	0.12 (4.82)
Fiscal Deficit/GDP		0.15 (3.55)	0.18 (4.16)	0.16 (3.85)	0.18 (4.23)
<u>Level of Indices for</u>					
Inflation (GDP Deflator)		0.19 (2.01)	0.19 (1.98)	0.05 (0.50)	0.11 (0.98)
Black Market Premium				0.19 (2.17)	0.14 (1.64)
Real Interest Rate on deposits				0.21 (2.15)	0.11 (1.13)
Political & Civil Liberties (Freedom House)				0.42 (3.04)	0.37 (2.58)
<u>Regions</u>					
East Asia			3.28 (5.17)		3.04 (4.76)
South Asia			2.29 (3.17)		1.61 (2.10)
Middle East, North Africa, South Africa & Zimbabwe			2.64 (4.02)		2.26 (3.41)
Latin America			1.76 (2.77)		1.39 (2.15)
Eastern Europe			1.14 (0.94)		0.82 (0.69)
Adj. R-squared	0.21	0.27	0.36	0.32	0.38
RMSE	2.92	2.81	2.63	2.72	2.29
No. of obs	229	229	229	229	229

Notes:

1. For definition of variables and their construction, see text and Appendix 1
2. Change in a variable refers to the difference in value from one period to the next.

Table I (c)**Dependent Variable:** *Level* of Per Capita Income Growth**Data:** Developing Country 24-year data from 1973 to 1997.

Independent Variables	Models				
	1	2	3	4	5
Constant	-2.79 (-2.32)	-1.59 (-1.20)	-0.37 (-0.29)	-1.03 (-0.80)	-0.08 (-0.06)
<i>Level of.</i>					
Initial Income	-0.04 (-0.23)	-0.12 (-0.74)	-0.25 (-1.32)	-0.49 (-2.26)	-0.46 (-1.99)
Investment/GDP	0.19 (7.15)	0.18 (7.08)	0.15 (6.32)	0.16 (6.35)	0.14 (5.83)
Fiscal Deficit/GDP		0.15 (3.01)	0.17 (3.98)	0.16 (3.33)	0.177 (4.10)
<u>Level of Indices for:</u>					
Inflation (GDP Deflator)		0.05 (0.39)	-0.04 (-0.39)	-0.20 (-1.21)	-0.16 (-1.04)
Black Market Premium				0.16 (1.41)	0.14 (1.34)
Real Interest Rate on deposits				0.30 (1.97)	0.06 (0.42)
Political & Civil Liberties (Freedom House)				0.25 (1.40)	0.22 (1.26)
<u>Regions:</u>					
East Asia			2.34 (3.97)		2.19 (3.58)
South Asia			2.19 (3.18)		1.85 (2.35)
Middle East, North Africa, South Africa & Zimbabwe			2.14 (3.56)		1.86 (2.76)
Latin America			0.49 (0.93)		0.21 (0.37)
Eastern Europe			0.19 (0.15)		0.44 (0.32)
Adj. R-squared	0.44	0.51	0.37	0.56	0.67
RMSE	1.62	1.51	1.25	1.43	1.24
No. of obs	65	65	65	65	65

Notes:

1. For definition of variables and their construction, see text and Appendix 1

2. Change in a variable refers to the difference in value from one period to the next.

Table I(d)**Dependent Variable: *Change* in Per Capita Income Growth****Data:** Developing Country 5-year data from 1968 to 1997, centered on 1970,1975,1980 etc.

Independent Variables	Models				
	1	2	3	4	5
Constant	0.83 (3.88)	0.78 (3.47)	-0.35 (-0.98)	0.63 (2.69)	-0.56 (-1.67)
<i>Change in..</i>					
Initial Income	-12.90 (-11.55)	-12.17 (-10.37)	-14.28 (-11.68)	-10.79 (-9.03)	-13.38 (-10.78)
Investment/GDP	0.18 (4.88)	0.19 (5.06)	0.16 (4.54)	0.13 (3.33)	0.11 (2.96)
Fiscal Deficit/GDP		0.11 (2.11)	0.11 (2.15)	0.17 (3.01)	0.16 (2.90)
<u>Change in Indices for:</u>					
Inflation (GDP Deflator)			0.22 (1.93)	0.18 (1.45)	0.08 (0.66)
Black Market Premium				0.11 (1.15)	0.07 (0.73)
Real Interest Rate on deposits				0.18 (1.86)	0.20 (2.18)
Political & Civil Liberties (Freedom House)				0.30 (1.27)	0.20 (0.91)
<u>Regions:</u>					
East Asia			3.16 (5.01)		3.24 (5.20)
South Asia			1.95 (2.52)		2.18 (3.09)
Middle East, North Africa, South Africa & Zimbabwe			1.63 (2.95)		1.51 (2.85)
Latin America			1.18 (2.36)		1.50 (3.00)
Eastern Europe			1.75 (1.42)		2.29 (1.90)
Adj. r-squared	0.40	0.40	0.46	0.43	0.51
RMSE	2.84	2.76	2.61	2.39	2.21
No.of obs	219	201	201	159	159

Notes:

1. For definition of variables and their construction, see text and Appendix 1
2. Change in a variable refers to the difference in value from one period to the next.

Appendix – 1

Variable Definitions and Construction

GDP Per Capita: measured in constant U.S. dollars, 1995. Source: World Bank, World Development Indicators, CD ROM, 1999 (hereafter referred to as WBCD)

Initial Income: For the 24 year sample (Table I(c)) this refers to GDP per capita, constant dollars for 1973. For the five year grouped data (Tables Ia, Ib and Id), this refers to the year preceding the construction of the period. For example, for the period 1968-72, it is the income for 1967; for 1983-87, it is the income for 1982.

Investment share and fiscal deficit: Data obtained from WBCD.

Indices of Inflation and Black Market Premium: The inflation index is based on pattern of GDP deflator observed for the entire sample of countries. For example, inflation for the 5th and 90th percentile was -2.04 and 33.02 respectively. This means that 5% of the economies had inflation of -2.04 or less while 10% of the economies had inflation higher than 33.02. Based on this inflation distribution, the index, on a scale of 0 to 10, was constructed. The middle value of 5 is given for inflation between the 40th and 50th percentile. A progressively higher value of the index means a progressively lower inflation. For example, the index has a value 8 if the inflation observed (say 1.4%) is greater than the 10th percentile (-0.14) but less than or equal to the 20th percentile (1.72) figure. On the other hand, a value of 3 is assigned for inflation greater than 60th percentile (8.08) and less than or equal to 70th percentile (10.38).

A similar procedure is followed for indexing black market premium. An index has the value 0 if the BMP is >211 (the 90th percentile figure) and the index is equal to 6 if BMP >1 (30th percentile) and less than 3 (40th percentile). For a BMP ≤ 1, the index is 10. Thus, the index has its lowest value, 0 when BMP is in the highest 10 percent category. And has its highest value when BMP is in the bottom 30 percent category.

Index of real interest rates: In this paper, real interest rate refers to the real deposit rates prevailing in the countries. The conventional view is that financial repression only exists when very low and negative real interest rates are observed. In this paper financial repression is defined as both *very high* and *very low* real deposit rates. Thus while constructing the index from the distribution of real interest rates, real deposit rates between 45th and 55th percentile is given a value of 10, between 55 and 65th percentile, 9 between 35th and 45th percentile is 8 and so on. Thus a very low real deposit rate (less than or equal to -11.8) has an index of 0 and a very high rate (>12.6%) is also perceived to be repressive, having an index of 1.

Political and Civil Liberties: This index is constructed on a scale of 1 to 7. 1 represents least free and 7, the most free state. Each year's index is an average of political and civil liberties. Source: Freedom House, Annual Survey of Political Rights and Civil Liberties.

Regional groupings: Among regional groupings, EMENA refers to Middle-East and North African countries together with South Africa and Zimbabwe. Others, such as South Asia, East Asia, Latin America and Eastern Europe are self explanatory.

References

- Barro, Robert J. 1991. "Economic Growth in a Cross Section of Countries", Quarterly Journal Of Economics, pp. 407-443, May.
- Barro, Robert J. and Jong-Wha Lee. 1993b. " International Comparisons of Educational Attainment", Journal of Monetary Economics, Dec.
- Barro, Robert J., 1997. Determinants of Economic Growth: A Cross-Country Empirical Study. Cambridge, MA: The MIT Press.
- Bauer, P.T., 1984. Reality and Rhetoric: Studies in the Economics of Development. London: Weidenfeld and Nicolson.
- Bhagwati, Jagdish and Desai, Padma. 1970. Planning for India's Industrialization. Oxford University Press.
- Bhalla, Surjit S., 1992. "Free Societies, Free Markets and Social Welfare." Mimeo, World Bank. Aug. Final Revision: Feb. 1994.
- Bhalla Surjit S., 1994. "Freedom and Economic Growth : A Virtuous Cycle?", in Democracy's Victory and Crisis: Nobel Symposium 1994 ed. Axel Hadenius. Cambridge University Press. 1997.
- Bhalla, Surjit S., 1997a. "Towards a Bill of Economic Rights", Partho Shome. Ed., Conference proceedings, National Institute of Public Finance and Policy, New Delhi, June 1997.
- Bhalla, Surjit S., 1997b. "Economic Freedom and Growth Miracles: India is Next", Draft prepared for a panel discussion on South Asia: The Next Miracle?, World Bank - IMF Annual Meeting, Hong Kong 1997.
- Bhalla, Surjit S., 1997c. "Eureka : KAC and the Laws of Flotation." Draft for World Bank Conference on "India: A financial Sector for the 21st Century Goa, India. December.
- Bhalla, Surjit S., 1999. "Chinese Mercantilism: Currency Wars and How the East was Lost", ICRIER Discussion Paper, March 1999.
- Dasgupta, Partha and Martin Weale, 1990. "On the Measurement of Well-Being." Mimeo. June.
- Dasgupta, Partha, 1990. "Well-Being and the Extent of Its Realisation in Poor Countries." Economic Journal (Supplement).100.
- Dorn, James A., 1993. "Economic Liberty and Democracy in East Asia." Orbis. Fall.
- Economist, 1991. "Freedom and Prosperity", June 29.

Farr, W. Ken, Richard A. Lord and J. Larry Wolfenbarger, 1998. "Economic Freedom, Political Freedom, and Economic Well Being: A Causality Analysis" in The Cato Journal. Volume 18, Number 2. Washington, D.C.: The Cato Institute. Fall.

Fogel, Robert W., 1999. "Catching up with the Economy." The American Economic Review. March.

Friedman, Milton. 1962. Capitalism and Freedom, University of Chicago, Chicago.

Gastil, Raymond D., 1987. Freedom in the World. New York: Freedom House Inc.

Gwartney, James and Robert Lawson, 1998. Economic Freedom of the World 1998/1999 Interim Report. Vancouver, BC: The Fraser Institute.

Gwartney, James and Robert Lawson, 1997. Economic Freedom of the World 1997. Vancouver, BC: The Fraser Institute.

Gwartney, James, Randall Holcombe and Robert Lawson, 1998. "The Scope of Government and the Wealth of Nations." in The Cato Journal. Volume 18, Number 2. Washington: The Cato Institute. Fall.

Hayek, Friedrich, 1944. The Road to Serfdom. Chicago: University of Chicago Press.

Hayek, Friedrich, 1948. Individualism and Economic Order. Chicago: University of Chicago Press. Midway Reprint, 1980.

Hayek, F. A., 1988. The Fatal Conceit: The Errors of Socialism, edited by W.W. Bartley III, University of Chicago Press, 1988.

Johnson, Bryan T., Kim R. Holmes and Melanie Kirkpatrick, 1999. 1999 Index of Economic Freedom, Washington D.C.: The Heritage Foundation & The Wall Street Journal.

Levine, Ross and David Renelt, 1992. "A Sensitivity Analysis of Cross-Country Growth Regressions" American Economic Review. Sept.

Lipset, Seymour M., 1959. "Some social requisites of democracy: economic development and political legitimacy", *American Political Science Review* 53: 69-105.

Lucas, Robert. 1988. "On the mechanics of economic development", Journal of Monetary Economics, July.

Messick, Richard E., Editor, 1996. World Survey of Economic Freedom 1995-1996, Freedom House: New Brunswick, USA.

Reserve Bank of India, Report of the Committee on Capital Account Convertibility, Mumbai, 1997.

Rodrik, Dani. 1997. "Democracy and Economic Performance." Mimeo. Harvard University. December, 1997.

Rodrik, Dani. 1998. "Who needs Capital-Account-Convertibility?" Mimeo. Harvard University. February 1998.

Scully, Gerald W., 1988. "The Institutional Framework and Economic Development", Journal of Political Economy, vol. 96, #3, 1988.

Scully, Gerald W. and Daniel J. Slottje. 1991. "Ranking economic liberty across countries" Public Choice, 69.

Skidelsky, Robert, 1997. The Road From Serfdom. New York: Penguin Books.

Wade, Robert. 1990. Governing the Market. Princeton: Princeton University Press.

World Bank, 1991. World Development Report 1991. Washington, D.C.

World Bank, 1993. The East Asian Miracle: Economic Growth and Public Policy. Policy Research Report. Washington, D.C. July.

