

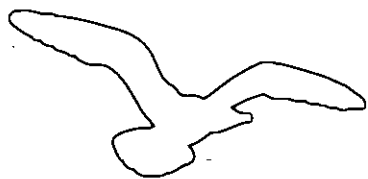
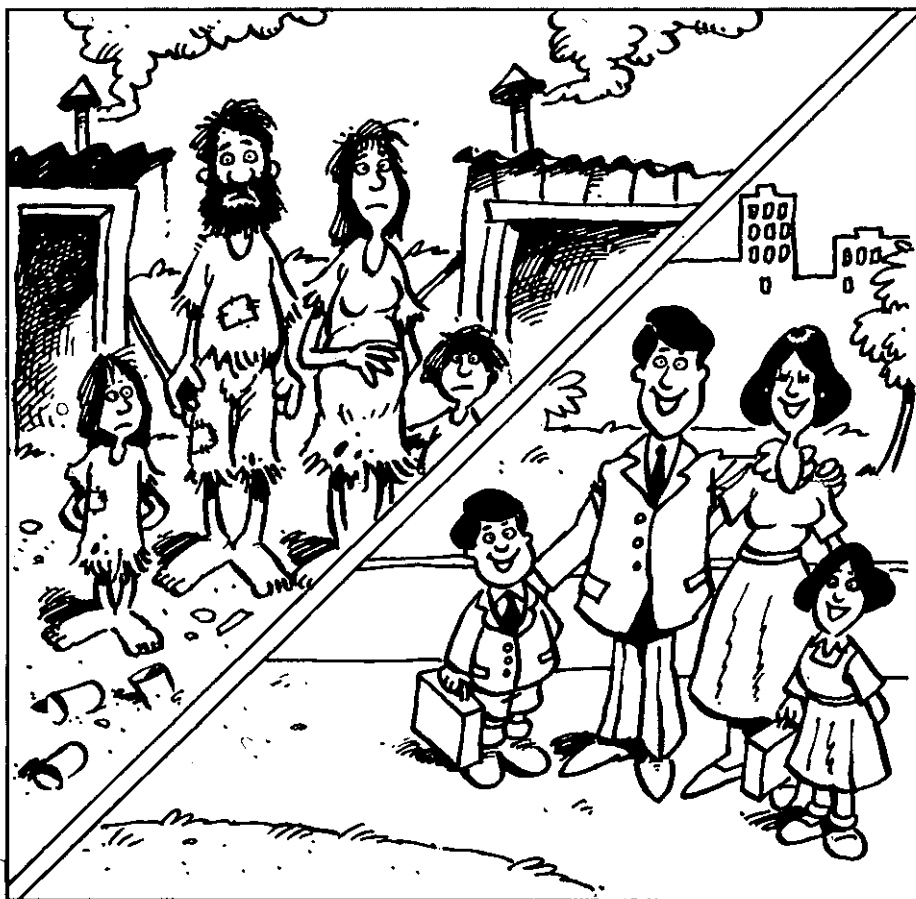
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The common sense of

WEALTH CREATION



MARC SWANEPOEL

The common sense of

WEALTH

CREATION

Marc Swanepoel

Drawings by Mark Wiggett
Edited by Lynn Freeman

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Describes what happens if governments ignore these principles. It explains why central planning always fails, and points out the unintended and detrimental effects of state welfare. It also stresses the importance of community organisations and shows how to eliminate poverty.

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Investigates the required framework for wealth creation. It discusses concepts like democracy, constitutions, bills of rights, the rule of law, and devolution of power. It then gives an example of the type of governmental structure which will ensure individual liberty and prosperity.

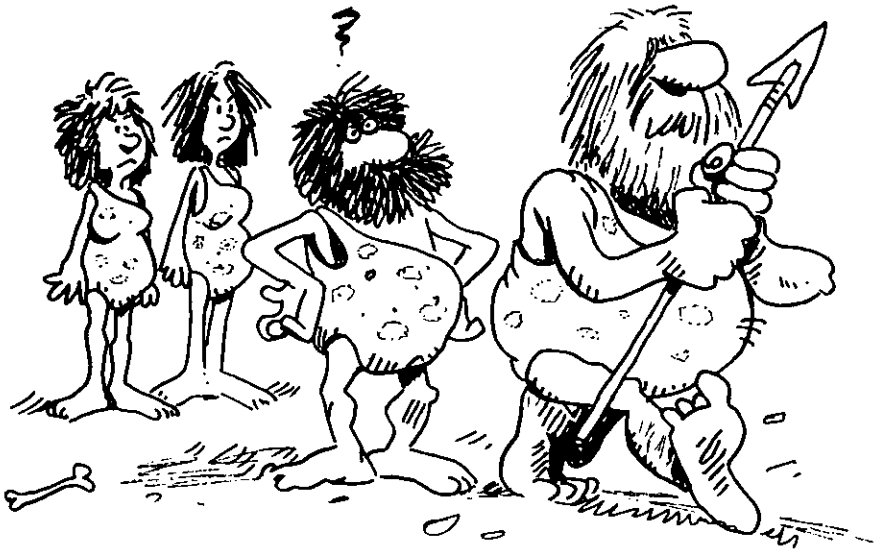
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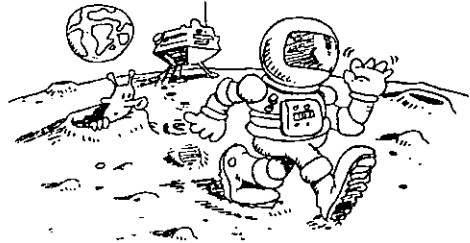
PART 1



DISCOVERING THE PRINCIPLES

IN THE BEGINNING

We live in an age where people walk on the moon. They can fly round the earth, and see the world from their sitting rooms.



We also live in an age where millions are poor, and where people still kill each other.



Many of us would like to see a different world. Where no one goes hungry, with schools, and jobs, and homes, and with dignity, friendship and pride.

Is this possible? We believe so. We believe that any society can be free and prosperous. But then it has to be built on the foundations of true freedom.

What are these foundations, and why do they work? Let's see. We'll start off by looking at history.



For millions of years, humans lived in small groups of 20 or 30 people, surrounded by enemies bigger, faster and stronger than themselves.

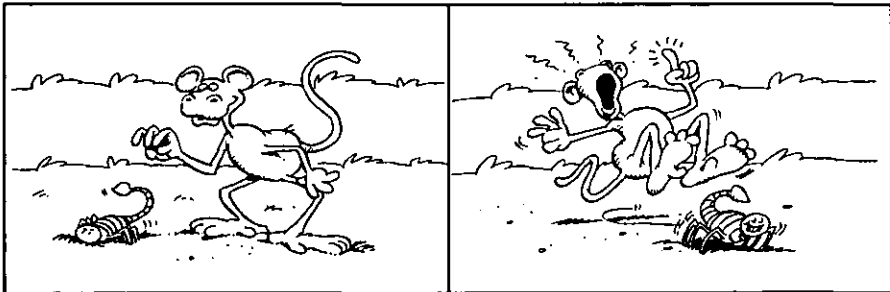
In the beginning, their development was very slow, but twenty or thirty thousand years ago, they were already very much like us. They looked like us and had the same intelligence. In today's clothes, very few people would even notice them.



Why then did it take them so long to develop into modern societies? The problem was that they did not have the right knowledge. Each of them knew a lot about hunting, or where to find shelter. But very little about anything else. Unfortunately, knowledge cannot be breathed in, like air.

Where does knowledge come from? One can get some just by being alive. A child, for example, who puts his hand in the fire, will immediately have the “knowledge” that fire is dangerous.

A monkey will get the same information in the same way.



This is a very slow process. It is the way animals learn. It is also the reason human beings lived like animals for so long. They still had to discover a better way of finding and testing new knowledge.

The climate of long ago was mostly cold and miserable. Under such conditions, humans could only do what nature allowed them. They struggled just to stay alive. Their groups were so small, because not many of them survived.

Up to that time, things like weapons were seen as belonging to the group and not to the individual. But then, some individuals accidentally stumbled upon a new custom which helped their groups to survive.

PROPERTY RIGHTS

The first person who started the new custom had no idea of exactly what he was doing. Maybe he was a nasty character who decided one morning that he was not going to share the weapons he had made with anyone else.

You can be sure that he was not very popular with the rest of the group. Imagine somebody not wanting to share! It was unthinkable!



However, he probably got away with it because he was stronger than the others.

Over the next few thousand years, other individuals also showed some signs of this new behaviour. They also kept weapons and other articles for themselves.



The groups which acquired this ownership of property, or **property rights**, were unknowingly changing the nature of human beings. Without realising it, they were giving birth to *individual incentive* and *self-interest*.

How did ownership of property make a difference to the survival of the group? It gave individuals the freedom to make



their own decisions. The owner of an axe or a spear had the freedom to use it in his own way. He could try new things because the weapons were his. He did not need anybody's permission. He acquired new knowledge and became a better hunter. The food supply increased to the benefit of the whole group.

Humans did not develop property rights because they were clever. They were just lucky that some individuals accidentally treated weapons and other articles as their own property.

Eventually the only groups which survived the dangers of long ago, were those with customs which allowed at least some individual property rights. These rights developed very, very slowly. The hunter of long ago owned his weapons, but not much else. He was still extremely poor.

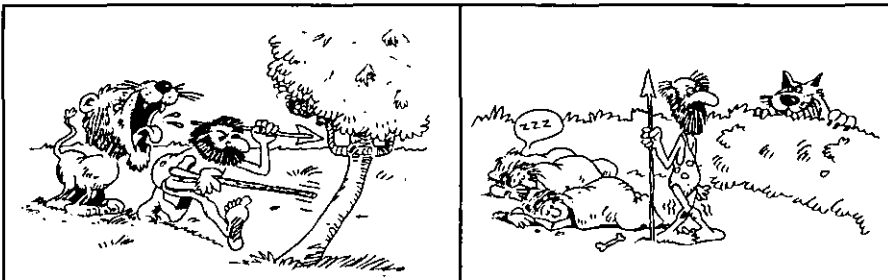
THE KNOWLEDGE PROBLEM

Ten thousand years ago, we got lucky again. The last ice age ended, and it became much warmer. In some areas, wild grains and other edible plants grew in great quantities. Many of the groups discovered this new source of food. They settled down, and became crop farmers.

Their new life style was very different from hunting. It allowed people to stay in one place where they could build shelters to protect themselves. It also allowed them to produce more food. Some groups now grew much larger. And this brought them to a brand new problem.



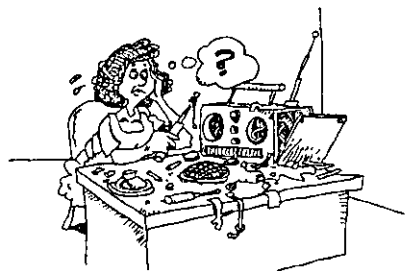
In the smaller communities of before, it was possible for a leader to tell everybody what to do. He knew the abilities of each member. He would, for example, never send somebody with bad eye-sight to hunt for food, nor would he tell the weakest person to stand guard against possible enemies.



He had this knowledge or information only because the group was so small! In bigger societies consisting of hundreds, or thousands of people, this became impossible. No leader, or

government could know enough about each person to tell him or her what to do.

The truth is that even the cleverest people don't know everything. You, for example, may know exactly how to bake a cake. You may know something about milking a cow. But, you may know absolutely nothing about fixing a radio. Yet, there *are* people who know how to do just that



All other people in the world are in exactly the same position. They may know a lot about a few things, but they know nothing about most other things.

The problem is that human knowledge comes in little chunks.

Each person has only a tiny piece of knowledge about the world.

With the small groups of long ago, these pieces were all very similar. That's why it was so easy for a hunter leader to direct everybody. He knew what everyone else knew.

In bigger groups, especially where individuals looked upon property as their own, the pieces of knowledge increased rapidly. The crop farmers learned all kinds of different things. Some acquired skills with building tools. Others, with plant-

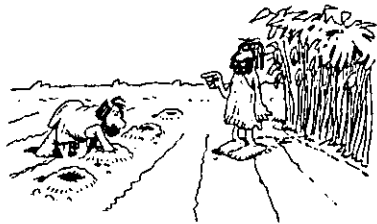
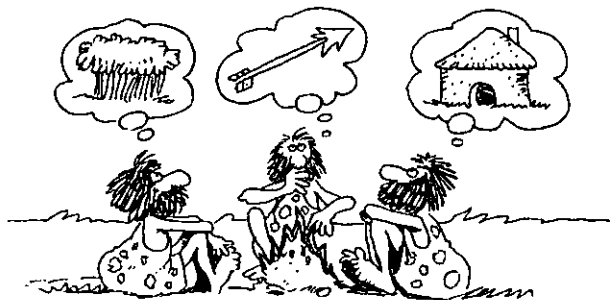
ing tools. Some people discovered what crops grew best in different types of soil, others, how deep to plant the seeds, and so on.

This information did not just come to the whole group in a flash. Different individuals discovered what worked best under specific circumstances.

But, as we can see, this information was not in the mind of a king, or a leader or a government. It was spread out in the individual minds of each and every citizen.

The problem was how to use all the scattered pieces of knowledge which were floating around in the heads of so many people. Before any society can become prosperous, it has to solve this “dispersal of knowledge” problem.

Of course, during those times, the leaders were not even aware of this problem. They went on, just as before, telling everybody what to do.



The groups remained primitive and poor for a *very long time*. How can one solve this “knowledge problem?” Well, no human being has

been clever enough to design a solution to this problem. But, fortunately for us, some societies found the answer without even realising it until long after it was already working. This did not just happen overnight. It took many thousands of years, as well as a few lucky breaks. And, as before, the solution had to do with **property rights**.

PROPERTY RIGHTS AND VOLUNTARY EXCHANGE

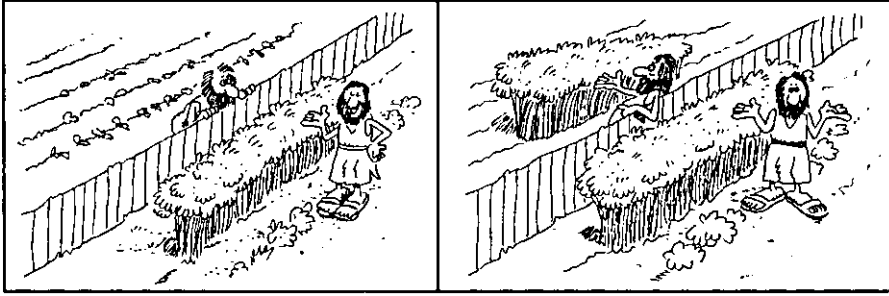
Many farming groups which survived the hardships of long ago, allowed individuals to own weapons, clothes and tools. But the land still belonged to the whole society.

In a few instances, however, some families began to treat the land which they worked as their own property. They never thought for one moment that their actions would benefit the group. Like everybody else, they were just trying to make a living.



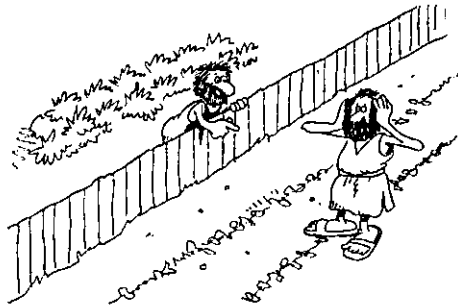
But, the societies which allowed this, soon became more prosperous than others. People could now instantly apply their own knowledge about a specific situation to their property. Nobody's permission was needed.

If, for example, a family produced more food for themselves by trying a new planting method, then the rest of the group also



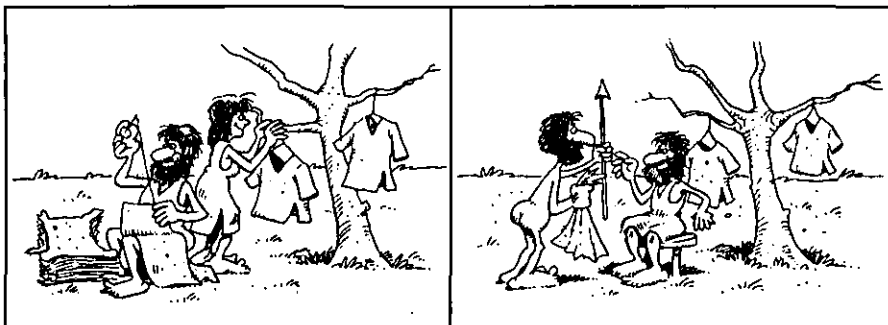
gained. They soon copied the new method. If, however, it was unsuccessful, the only people who suffered, were those who had tried something new.

Remember, ownership of property goes hand in hand with *risk*. Those who tried something new with their own property, were taking a chance. Therefore, they tended to be more careful. They took *calculated risks*.



Ownership thus resulted in two very important changes in human attitudes: individuals became *enterprising* and *careful* with their own property. This led to the continuous discovery and testing of new knowledge. The whole group benefitted from successful experiments, but did not suffer from individual mistakes.

Ownership also gave individuals and their families an incentive to become *better* at what they were doing. If a person or family was very good at making clothes, they could exchange these for something else. Other people would ask them to make clothes in exchange for food, or seed, or weapons. They improved their skills, and soon became **experts**.

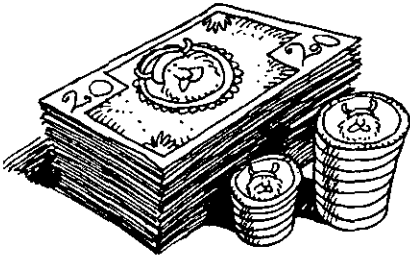


Others became experts at shoe making, or tool making, or house building. People were now able to concentrate on what they could do best!! Economists call this the “division of labour.” It should in fact be called the *division of knowledge*. It allowed individuals or families to acquire *specialised* knowledge about different things.



Of course, when people became experts at making clothes, they did not have much time to grow food or build shelters. They had to trade or exchange their goods for products made by others. Such societies became trading societies. Property rights thus resulted in specialisation and trade, and this, in turn, led to the next important step towards the solution of the knowledge problem: *the development of money*.

THE DEVELOPMENT OF MONEY



Money, like property rights, was not invented by any clever person. It also came about accidentally - through the actions of people who never realised what these actions would lead to.

At first, they simply exchanged one product for another. Sometimes, this was very inconvenient. If someone had a cow and wanted shoes, he was in trouble. Who would exchange a valuable cow for a pair of shoes? Some products just could not be cut up into smaller pieces, and this made trade very difficult.



The problem had a solution if one could exchange the cow for some valuable product which *could* be cut into smaller pieces. *One* such piece could then be exchanged for the shoes. And, one would have many pieces left to exchange for other things.

Many products, like sea shells, beads, iron, salt, gold, and silver were tried for this purpose, that is, to serve as a *medium of exchange*. Eventually, after thousands of years, gold and silver remained as the most suitable ones. The gold and silver, when used for exchange purposes, was called **money**.

This made trade much easier. One could now exchange any article for money, and then exchange some of the money for

other things. The money *oiled* the exchange process. It allowed trade to flow more smoothly.



Let's just look at the whole process one more time.

- Older societies developed so slowly because they had no way of finding and using new knowledge.
- Property rights led to the rapid discovery of additional knowledge, and to the specialisation of such knowledge. Individuals or families became experts at certain jobs.
- This allowed them to produce many different products which they could exchange with each other.
- Money then developed as a means to make these exchanges easier.

Two steps were now still required to finally solve the “knowledge problem.” This problem, as we know, is how to use all the different pieces of knowledge in the minds of many people, for the benefit of all. These two final steps did not come about through the wisdom of kings or governments. They were completely unforeseen and unplanned.

Let's see how they happened.

THE PRICE SYSTEM

The next step towards solving the “knowledge problem” came about through the use of money. In societies where it was used, people began to value their products and services in money terms.

For example, if somebody exchanged a jacket for, say, 5 coins, then the price of the jacket was 5 coins. If another person exchanged his labour for 8 coins per day, then the price of his labour was 8 coins. And so on.

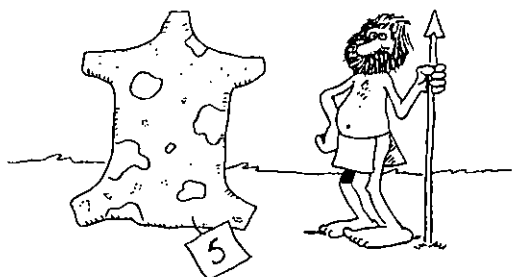


Many transactions were done in this way. Mil-

lions of people, just by buying and selling, helped to bring about this system of prices. Nobody designed it, and it took more than two thousand years to develop.

The prices of products and services became carriers of information. They were the signals or road signs which told everyone, especially producers, what was happening in the economy.

If a jacket maker saw the price of skins, he would be able to make an immediate decision about jacket production. The skin prices and the selling price of his jackets were *signals* which gave him the necessary information to decide what to do.



If he thought the skins were “cheap,” he would make more jackets. If they were “expensive,” he would cut back his production. He did not have to know who the hunters were, or what they were doing. All the information he needed, was contained in the *price signals* of skins and jackets.

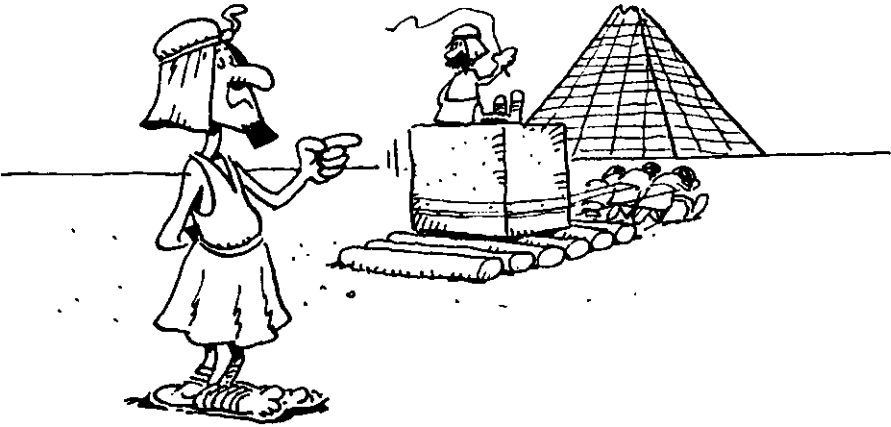


In the same way, the hunters could see from the prices they got for their skins, whether they had to increase or decrease their hunting.

Other people, using the same price information, could see if there was an opportunity to *replace* skins completely with some cheaper product.

Prices contain important information which buyers, sellers, workers, employers, inventors, or anyone else may need for making decisions. They are the signals or *road signs* which tell people what to do under any given circumstances.

GOVERNMENT AND THE PRICE SYSTEM



The “knowledge problem” was now very nearly solved. There was only one more obstacle to overcome: it was necessary for kings and governments to stand aside so that this system of prices could work properly.

This was a major problem. For thousands of years, kings and governments took it for granted that all societies had to be planned by the leaders. Wise men of the time had no idea how the price system worked, and they were in full agreement with such planning.

Fortunately, in one or two countries, luck was on our side once again. Five or six hundred years ago, many people in those countries already believed very strongly that individuals had property rights with which governments should not interfere. They wanted to see government as a protector of people’s freedom, and not as an organisation running their lives.

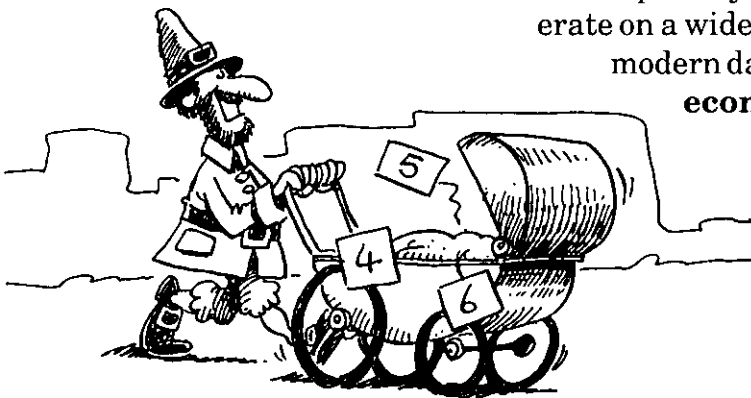
Fortunately for them, those few societies then had rulers who were not all that interested in ruling. Many of them preferred to go hunting,....



or to chase after the ladies.

Some of them could not even speak the language of the countries they were supposed to rule. The result of this was that the price system developed rapidly without much government interference. Some people became even more convinced that they should be left alone to do their own thing.

These ideas spread, and more people demanded the right to own property, and to live their own lives. Finally, after thousands of years, and only in a few countries, governments allowed the price system to operate on a wide scale. The modern day **market economy** was born.



THE MARKET ECONOMY

Through the price system, the market economy solved the age-old problem of using individual pieces of knowledge in the minds of millions of different people, for the benefit of all.

For the first time, societies could become prosperous because they had the means of using knowledge more efficiently.

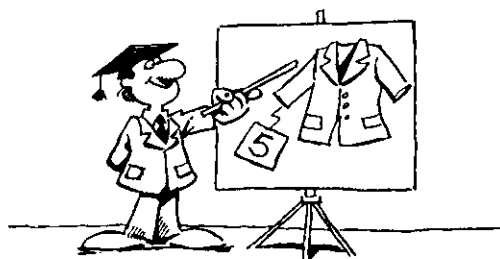


The few market economies which started about 300 years ago did not have governments which *never* interfered in the affairs of their citizens. But their governments interfered much less than others.

Today, if one looks back over the years, there is no doubt that countries with market economies are more prosperous than those where governments have tried to “plan” society.

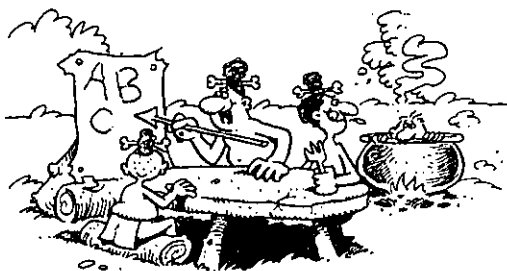
Most of the “planners” have meant well. But, they were unable to use the knowledge in their societies as efficiently as the price system could.

Their plans all ended in failure.



The truth is that, in spite of all our scientific achievements, human beings are not as clever as we would sometimes like to believe. This applies to individuals and to governments.

We accidentally stumbled on *property rights* and the *price system* as a way to overcome this ignorance. Millions of people were involved in its development, but nobody designed it. This may sound a bit like magic. How can human beings develop something without there being a designer?

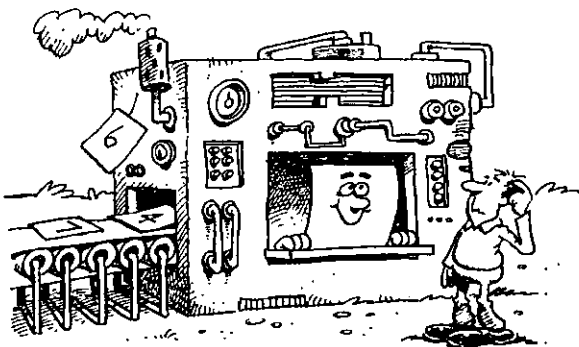


Well, take any language as another example. People living in the deepest jungles have languages with complicated grammar rules. Who designed them? Certainly not those primitive tribes-

men. Like the price system, language developed as a result of human action, but not through human design. At no time did the people who speak a language sit down to work out the sounds, the meaning of the words, or the grammar. It developed very slowly, over long periods, just because many people used certain sounds in a particular way.

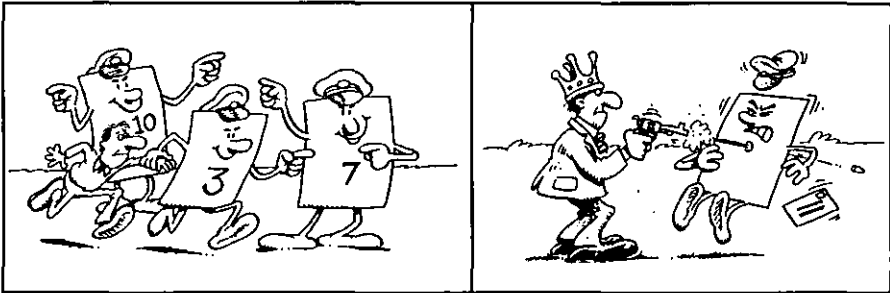
Yet, languages and the price system are much more complex than anything which humans could have designed on purpose. Other examples where complicated systems developed due to human action but without human design, are morals, the law, and customs.

Economists have realised only recently that the price system acts like an enormous information and advice service. Prices are signals which tell us



what is happening in the economy. They are messengers which give us information about what we should or should not do.

That is why governments should never control prices. It is like killing the messenger who brings bad news.



Property rights thus

- led to specialisation,
- which led to trade,
- which led to money,
- which led to the price system.

Without property rights, the price system could not have developed. And all societies would still have been as primitive as ten thousand years ago. Property rights, a sound monetary system, and a government which allows the price system to do its job, are the foundations of freedom and prosperity. They are the building blocks of civilization.

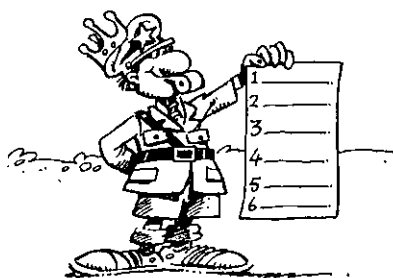
In a true market economy, all people have the right to own property. It is a society





where all exchanges between individuals are voluntary. People should not be allowed to use force or fraud in their dealings with each other.

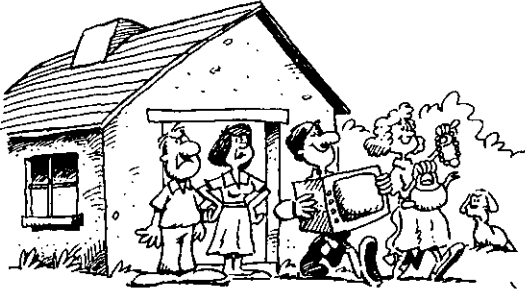
It works best in a democratic society where government is the protector of people and not their master. In this role, the government has functions which are clearly spelled out, like a job description, in a written document, called a **constitution**. Through such a constitution, one can *limit* a government's involvement in the lives of its citizens.



Some people sincerely believe that government can be used as an instrument to bring about prosperity, equality and a general redistribution of wealth. Unfortunately, this is not possible. Even the most well-intentioned leaders are not smart enough to do better than the price system. The unintended consequences of their interventions will lead to poverty, a breakdown of the price system, and the eventual collapse of that society.



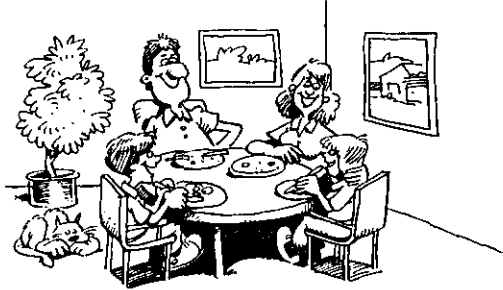
A market economy is not, as many people think, a selfish society where the rich get richer, and the poor, poorer. It is a society with moral values, without which, it cannot survive.



It stands on the foundation of *individual property rights*. And it relies to a large degree on people following *moral rules*, like honesty. Without honesty, just imagine what would

happen to one's property every time someone came to visit.

In a market economy, the *family* also plays a very important role. It is the one place in society where sharing is still practised on a regular and voluntary basis. In a way, it is like the small hunting groups of thirty thousand years ago.

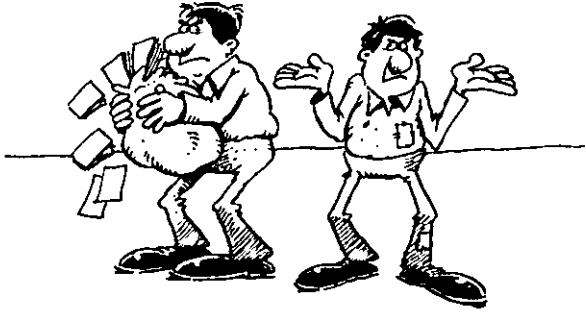


It is also the place where one gets the *values* which make a market economy possible: respect for property, honesty, responsibility, fairness, and compassion.



SELF-INTEREST

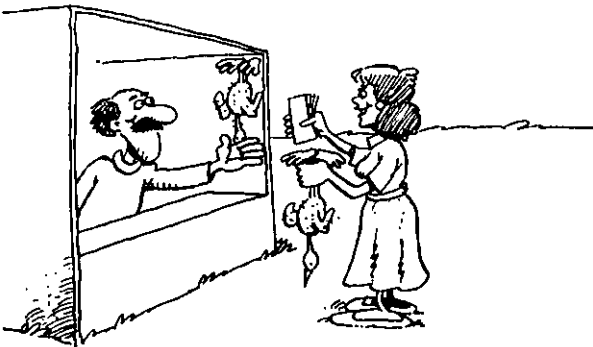
What about self-interest? Don't a market economy and self-interest go hand in hand? And will such a society not eventually destroy itself through selfishness?



Self-interest does play a very important role. In fact, it is the engine which supplies energy to such a society. At the same time, the economy and self-interest are steered by the price system - with unexpected results: *a market economy uses the self-interest of individuals for the benefit of society.*

How can that be possible?

Remember, in a market economy all transactions should be *voluntary*. One is not allowed to use force or fraud when dealing with others. Therefore, if you want something from me,

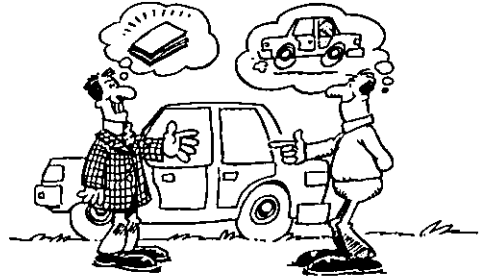


and you are not allowed to use force, then there is only one thing for you to do. You have to offer me something which *I* want. You have to act in *my* self-interest.

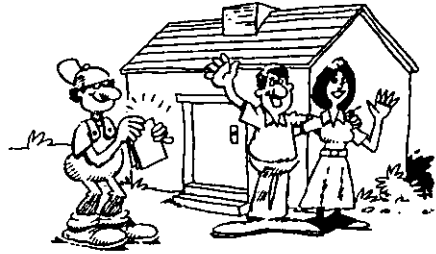
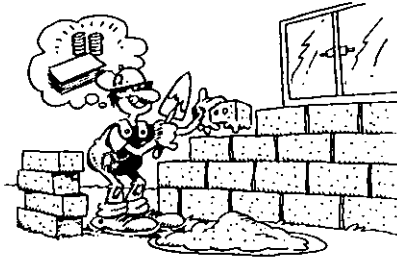
How do you like that?

In a market economy, you can only act in your own self-interest, if you act in someone else's self-interest at the same time.

Economists call this the "invisible hand."

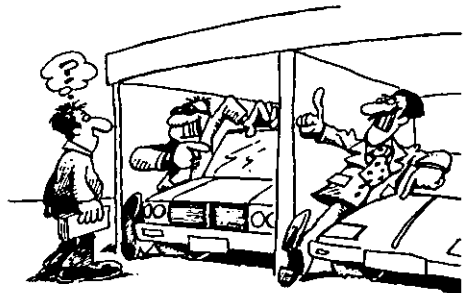


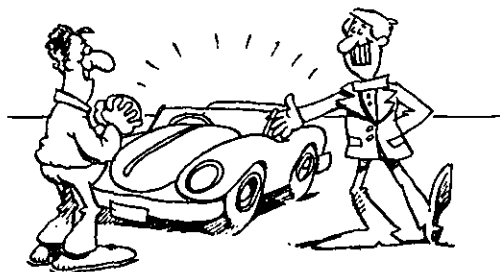
If people act in their own self-interest, then, in a market economy, it is as if there is an *invisible hand* which directs them so that they will benefit the community, even if that is not their intention.



COMPETITION

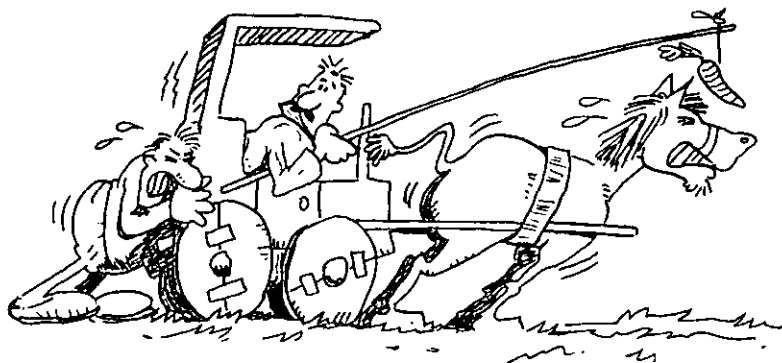
In a society based on private property and the price system, people *compete* with each other in the production of goods and services. Some critics see this as wasteful.



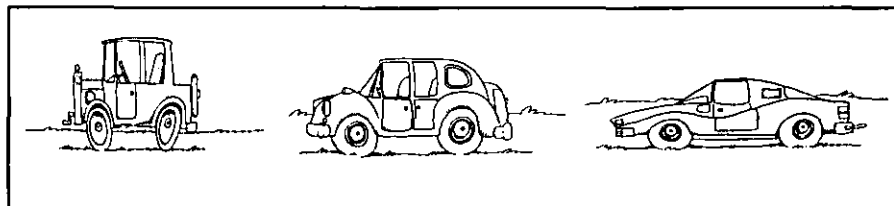


Unfortunately, there are even some economists who do not understand this aspect of a market economy. Competition is a way of *discovering* people's needs, how best to satisfy them, and, very importantly, by whom.

The first person who made a motor car did not know what people wanted, nor the best way to build it. He made many mistakes before he had a product which could be sold to a few willing buyers.

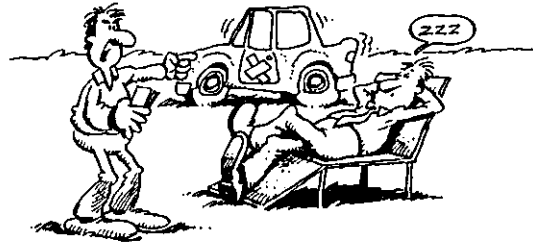


Newcomers then had to find *better* ways of building cars if they wanted consumers to buy from them. Through competition and guided by the price system, they continuously discovered new improvements.



Just remember, there are many different ways to build a car. And there are many other uses for the raw materials and labour which go into the making of a car. How does one know which mix is best? Or what other uses there are for those raw materials and labour?

Only through competition. Without competition, the discovery process would stop. There would be no incentive to find better ways of making cars. And there



would be no way to find out who could best supply us with cars.

THE DEMOCRACY OF THE MARKET

In a true market economy, buying is a bit like voting. If we buy from a certain shop, we are voting for that shop with our money. If many people do the same, that business will do well. If nobody votes for the shop, it will close down. In the same way, if lots of people spend their “money votes” on a certain article, then producers will make more of it. If nobody spends money on an article, it will not be produced any more.



A market economy is probably the best example of democracy one can get. It allows *all* people to vote, through their spending, for what *they* want. Even children can vote in this democracy.

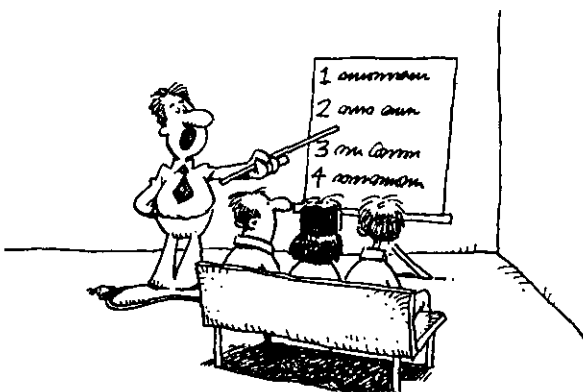
And one can *change* one's vote every day. If you don't like the way the shopowner treats you, you can change your buying vote and go somewhere else.



If the shopkeeper wants your money, he has to be very careful how he treats you. No disrespect and no discrimination. Otherwise you will vote for the shop next door!!

There are other names for a market economy. Some people call it *capitalism*, or *free enterprise*, or the *free market*, or *economic freedom*.

But, many societies which go under these names, are not really market economies. Remember, the foundations of a market economy are private property, voluntary exchange, and limited government.



Most importantly, only the market economy can solve the knowledge problem. That is, of using the different pieces of knowledge in society for the benefit of all.

No individual, king, or government is clever enough to do that. Many have tried, but, in the long run, they have all failed.

This does not mean that a market economy can sort out everything. Some problems are just not that easy to solve.

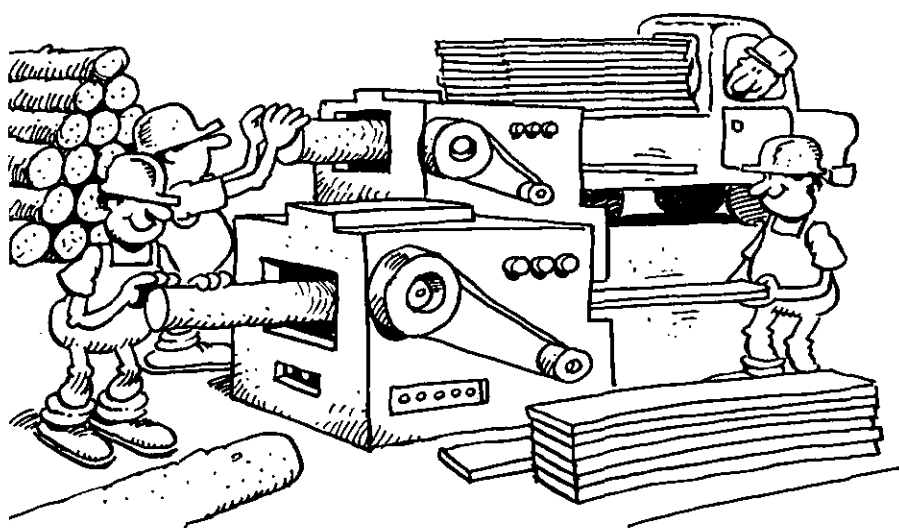


A market economy,

- where all citizens can own property,
- where they are free to use such property for their own purposes,
- where nobody may use force or fraud,
- and where the government allows the price system to do its job,

is the only society where there can be peace, prosperity, and justice for all.

PART 2

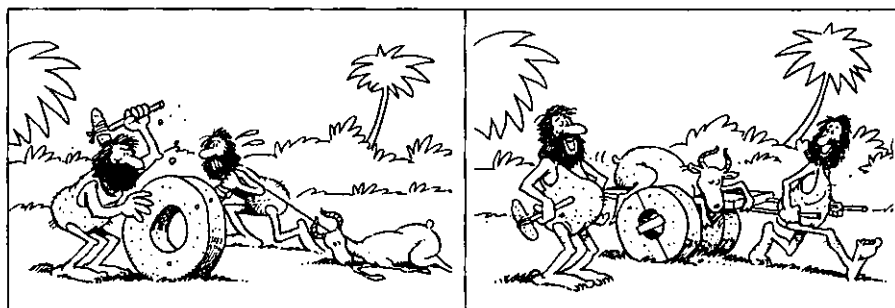


APPLYING THE PRINCIPLES

THE CREATION OF WEALTH

In this section we will look at poverty, and the creation of wealth. We will see what makes prosperity possible, and how to eliminate poverty. We will also look at the important roles which the **State** and the **community** can play in bringing about a better society.

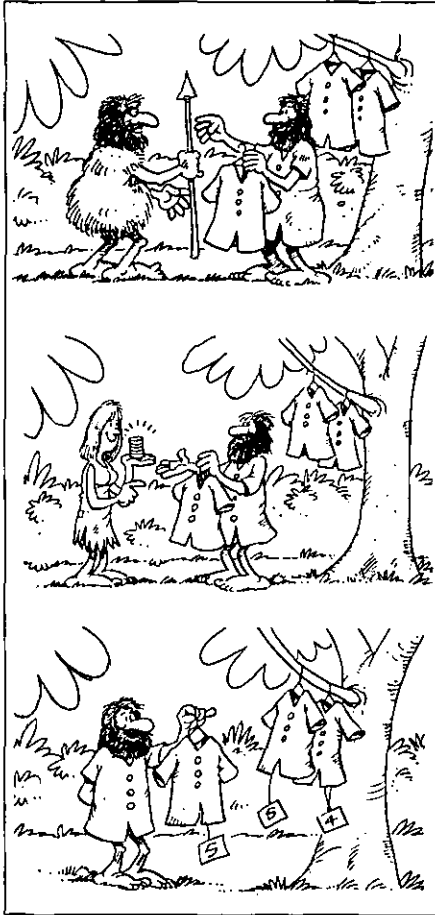
As we saw in Part 1, all societies have to solve certain important problems before they can become prosperous. Firstly, they have to find ways of *discovering* new knowledge, and then they have to use or apply such knowledge efficiently.



For millions of years, humans were *not* able to do this. They were poor and primitive.

However, as we have seen, during the last 50 thousand years or so, we got lucky. We accidentally found an answer to these problems - the **private ownership of property**. Private property became the foundation of prosperity. It allowed people to become experts at different jobs. Economists call this the 'division of labour.'





This led to trade, which led to the invention of money, which led to the development of the price system.

The price system allowed knowledge to be used more efficiently. People learned quickly how to satisfy many different human needs. They became prosperous.

Societies where governments allowed the price system to do its job, became known as **Market Economies**.

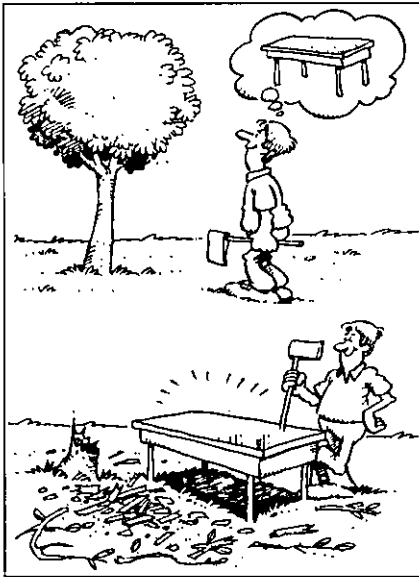
A king of old may have thought that he was wealthy because he had gold and diamonds by the barrelful. But he still had to ride on horseback, he had no running water, and his daily living was very primitive.

Ordinary citizens of those times were desperately poor. They were lucky if they lived to the age of 30. In a modern day market economy, millions of people, earning wages, are better off than the wealthiest kings of bygone days.



All this has been made possible by the process of wealth creation.

Unfortunately, it is a fragile process which few people understand, and can very easily be destroyed.



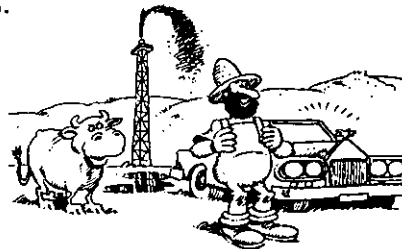
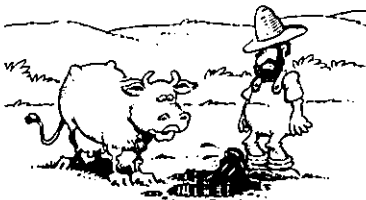
Wealth is created when people change natural and other resources into products which can be used. They add value to the resources.

This can be a very difficult and complicated process. In fact, there are still many countries with lots of resources, but where people have not yet learned how to turn them into wealth.

As human beings, we have been surrounded by such resources for millions of years. However,

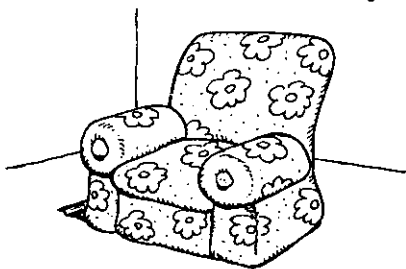
for most of that time, we had no idea how to use them.

Early American farmers, for example, complained bitterly about the sticky black stuff which sometimes interfered with cattle farming. Much later on, they learned how to *use* the same black stuff – oil – for fuel. And they were very happy to *have* some on their properties.

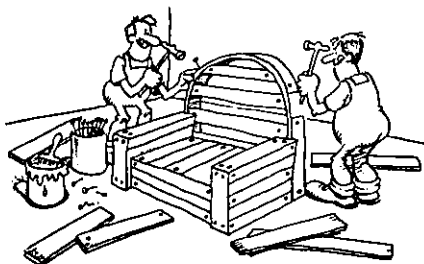


THE STRUCTURE OF PRODUCTION

Let's look at the process of wealth creation more closely. As an example, we'll take the production of a fairly simple object - a chair. We will see that the production process itself is not as simple as one might think.

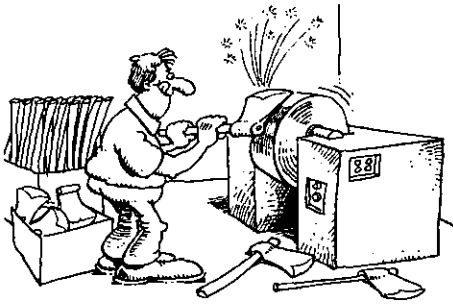


To start, one must first plant the right kind of tree, and wait a few years for it to grow. Then the tree must be cut down, the branches must all be stripped, and the log transported to a factory to be cut into planks. Another factory must plane the planks and make them into the frame of a chair.



At the same time, maybe in another country, a farmer has to plant cotton or raise sheep. Otherwise, where will we obtain the material for upholstery? And what about things like nails, glue, and paint?





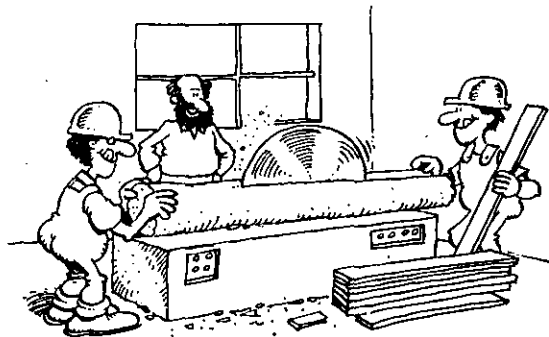
Many different types of tools and machinery will be used throughout the production process. One will need axes, tractors, trucks, hammers, saws, and many, many other things.

Different types of workers will also be required. From ordinary labourers, to truck drivers, carpenters, upholsterers, furniture designers, cotton weavers, axe makers, wool spinners, miners, painters, and so on.

Now, how do the axe makers know how many axes to make for cutting down the trees? And, of course, the axe makers *also* use machinery for making axes. How many of *those* machines must be built?

How does the cotton farmer know how much cotton to plant for the upholstery? Or what about the iron ore needed for the axes? How much of that should be produced? Producing a chair can become very long and complicated.

And this is true for all production processes. People design machines, which make machines,.. which make machines, which are finally used to make consumer products.



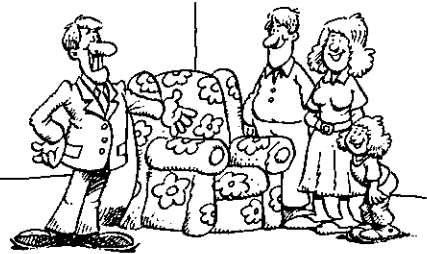
All along the line, there must be workers with the right skills. It is this complicated and interlocking *structure of production*

which makes wealth creation on a massive scale possible. The different processes can take place in different countries, involve thousands of people, and take many years.

No government, individual, or group of intellectuals can design this structure. But the price system can. It relies on the fact that most people tend to act in the interest of themselves and those they care for.

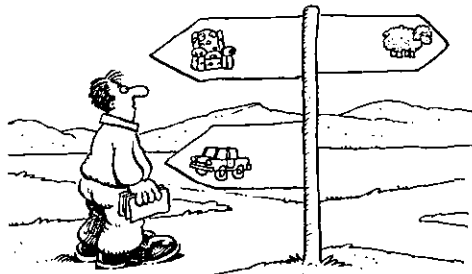
PRICES AND PRODUCTION

The people who make chairs may know *nothing* about the structure of production. All they are interested in, is *how much* they can get for their chairs. That will determine whether they will make *more* or *fewer* chairs.



In the same way the people who plant the trees, or make the nails, or do the upholstery look at **prices** to see what *they* should be doing. The *users* of the chairs will have no idea how they were made. They look only at the quality and the *price*. These prices change *continuously*. They are the *road signs* which guide the market economy.

As a result, it produces wealth at the right place, in the right quantity, for the right purpose, at the right time.



The market economy allows millions of citizens, who may not know or even like each other, to co-operate in the production of wealth. It allows workers, managers, and owners to become partners in the process of adding value to natural resources.

CRITICISM OF A MARKET ECONOMY

Many critics would *agree* that the market economy is a very efficient production machine.



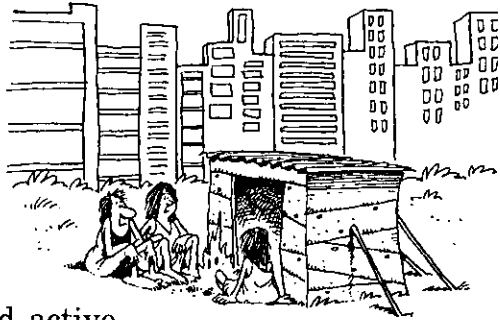
However, they say, only *some* people become wealthy, and they *exploit* the ignorance of others. The rich grow richer, while the poor suffer. And this, they say, is the reason why governments *have to* interfere.

There should, they argue, be a “mix” between the *efficiency* of the market, and the *welfare* functions of a democratic government.

This “mixed economy,” they say, *will* allow wealth to be created, but, at the same time, will see to it that everybody gets an equal share. The resources of society, they say, would then be used to benefit *everybody*, and not only the wealthy few.



It is true that, in many countries which call themselves **market economies**, there are poor people. There is unemployment, illiteracy and crime. Is this not a clear indication that governments *have* a very important and active role to play in the upliftment of the poor?



During the last 50 years, many governments throughout the world have tried to eliminate poverty in many ways. Let's see what we can learn from their experiences.

THE PLANNED ECONOMIES

Some African and East European governments thought that they could wipe out poverty by *planning* all aspects of society. They wanted to treat their countries like a huge factory where wealth creation could be *planned* by clever people.

Unfortunately, in those controlled or centrally planned economies, property rights were affected. After all, how could individuals be allowed to make decisions about their property when these could be in conflict with state planning?

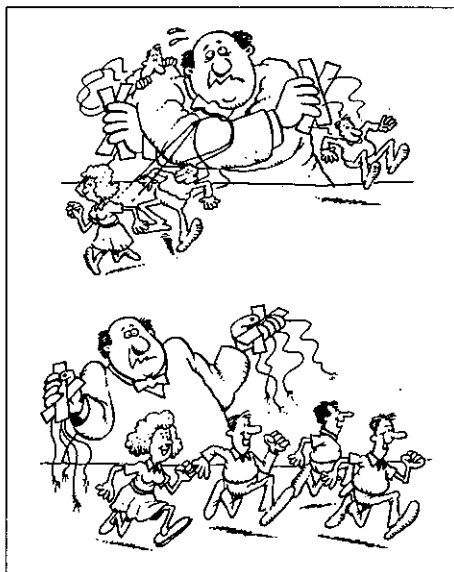
As we know, without property rights there can be no price system – with serious consequences. Remember, it is *only* through the price system that it is possible for us to solve the knowledge problem. That is, how to use all the pieces of

knowledge scattered throughout society in the minds of different people.

And, as we have seen in our story about the chair, it is *only* through the price system that millions of citizens can co-operate with each other in the production of wealth.

No leader, government, council, parliament, or computer, can *ever* achieve that. Wherever governments have tried to *plan* their economies, their plans have always failed. Many of them meant well. But, unfortunately, their interference destroyed the **price system**.

All the centrally planned economies eventually found themselves in trouble, and during the 1980's there was a massive swing *away* from them. Many people now realise that central planning does not lead to prosperity, and that governments *have* to relax their control.



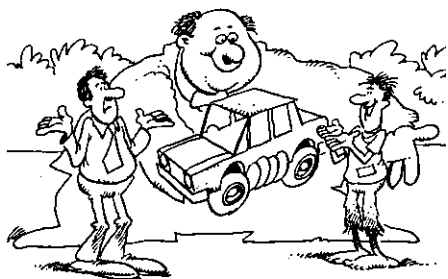
Of course, there are still a few die-hards who believe that it *can* work, that is, if only *they* are in charge of the planning.

The **process** which makes prosperity possible rests on the foundations of *property rights*, *voluntary exchange*, and the *price system*.

Central planning makes this process very difficult, if not impossible.

GOVERNMENT WELFARE PROGRAMMES

Not all countries chose central planning as the way to end poverty. Many of them realised the importance of the market in creating wealth. *They* wanted to give some of this wealth to the less fortunate members of society, *after* it had been produced.



In that way, they thought, government would *not* interfere in the economy, wealth creation would continue, *and* the poor would benefit.

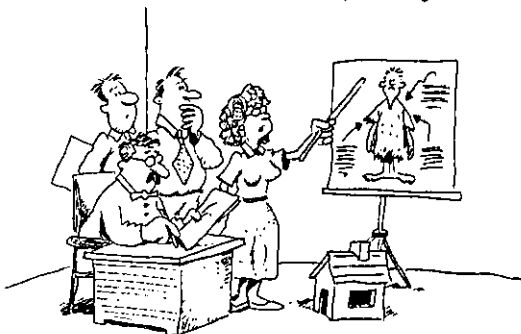
Places like America, Britain, and certain West European countries, believed that government *welfare programmes* could eliminate poverty without destroying wealth creation. Thus, from the 1960's to the 1990's, their governments spent enormous amounts of money to uplift the poor.

Through social security payments, food stamps, housing subsidies, job creation programmes, assistance to unwed mothers, education grants, and so on, governments tried their best to help poor people.



THE UNINTENDED CONSEQUENCES

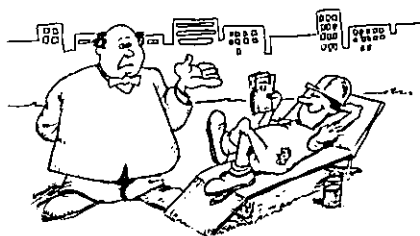
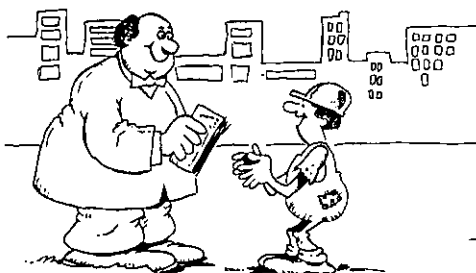
Were the programmes successful? There is no doubt that *some* poor people benefitted from them. But, many critics remarked that the ones who benefitted *most*, were not the poor at all, but those middle class people whose job it was to devise and run the programmes.



In fact, experience has *confirmed* that people generally act in their own self-interest.

This is true for the people who *receive* welfare, for those who would *like* to receive it, for the ones who have to pay the *cost*, and for the people who *administer* it.

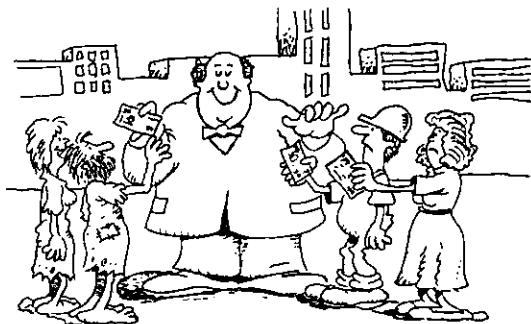
Take, as an example, those who *receive* welfare because they are unemployed. What will happen to their *incentive* to find or keep a job? Will it not be in their self-interest to *remain* unemployed?



Or what about those who fall *just* outside the requirements for receiving welfare? It will surely be in their self-interest to complain bitterly that they should *also* get something. And, if the government wants to

win their votes in the next election, it will *have* to include them. The *cost* of welfare will continue to rise.

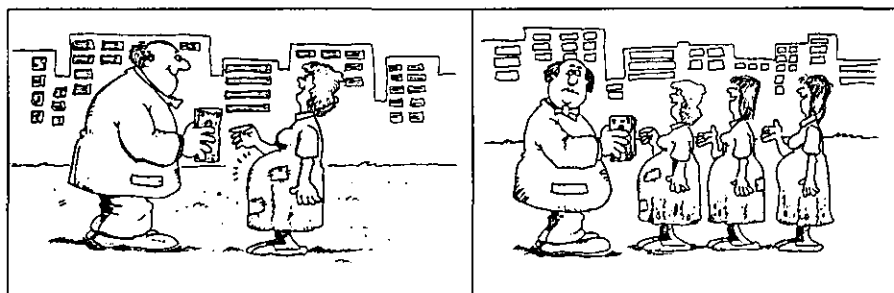
And what about those who *pay* the cost? How will *they* react? Remember, governments cannot spend *any* money *unless* they first take it away from *somebody else*.



Unfortunately, big welfare programmes go hand in hand with higher taxes. And higher taxes affect the actions of those who have to pay them. They soon discover that it is not in their self-interest to be very productive.

After thirty years of designing and re-designing all kinds of programmes to help the poor, it has become clear that the poverty problem has not been solved. Welfare programmes have consequences which were not foreseen by governments.

For example, efforts to help unwed mothers, resulted in *more* unwed mothers. The welfare payout became an *incentive* to fall pregnant and not to get married. This, in turn, resulted in more households where children grew up without the stabilising influence of a mother *and* a father.

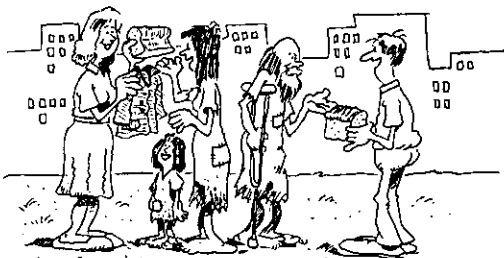


Many other problems appeared. Unemployment *increased* among the poor, and so did crime. More poor children went to school, but the *quality* of education dropped.

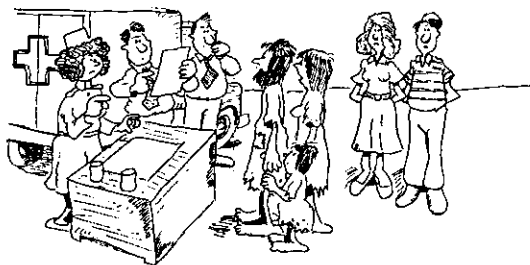
Lastly, and probably most importantly, government welfare destroyed certain community organisations.

THE IMPORTANCE OF COMMUNITIES

In the past, families and communities looked after their own poor. Private welfare organisations, run by the community, developed in a natural way to fulfil this very important function.



When well-meaning governments took it upon themselves to help the needy, many of these organisations disappeared.



Their functions were taken over by state officials, professional welfare workers, and others. But, when people lost their community organisations, they lost something

very important. Such organisations serve *other* functions, besides helping the poor, which governments cannot.

What are these other functions? Well, human beings have many different needs. In fact, there is a lot of truth in the

saying that money alone cannot buy happiness.

We *do* need material things like food and shelter. But we also have a need for *safety*, a need for the approval and respect of others, *and*, a belief that what we do, matters, that is, a need for self-esteem.

How do we normally satisfy these needs? Well, some people can do it all by themselves. For example, they may have the potential to be great achievers. They may do well in business, they may be great athletes, or even great politicians.

Such people normally get material wealth, the respect of others, and the feeling that they are important. That is, they are able to satisfy all their needs through *their personal abilities*. They will be successful in whatever society they live in.



Most of us are *not* that lucky. We do *not* have those special abilities. So, how do ordinary human beings get respect and self-esteem? As a member of a community.

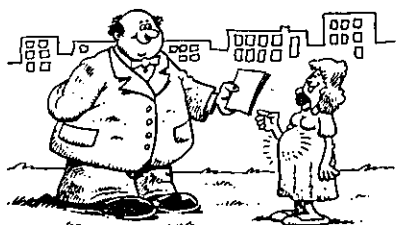
Ordinary people can be highly respected pillars of their community organisations. Especially when their organisations help the poor and the elderly, or when they serve in an organisation which controls the education of their children, or the safety and upliftment of their neighbourhood.

Government welfare has led to the virtual disappearance of such organisations. At the same time, it has destroyed the *only* opportunity some people have of becoming respected and self-respecting members of a caring community.

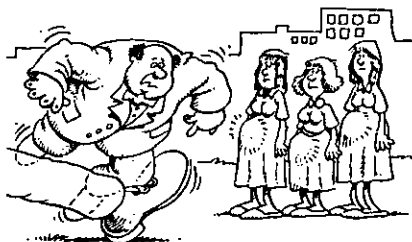
THE INVISIBLE FOOT

So, what is the answer? Should governments not be involved in helping people at all?

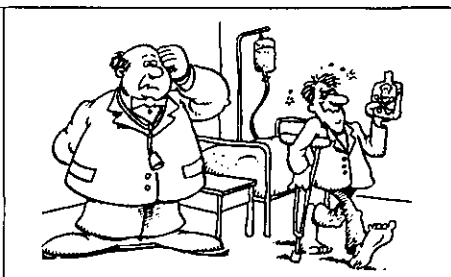
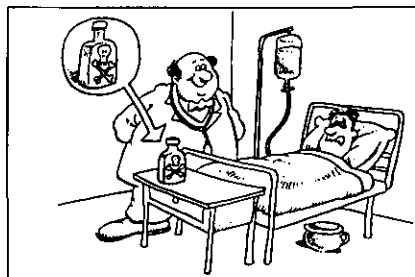
Adam Smith, the famous economist, said that if one allows people to act in their own self-interest, then, in a market economy, it will be as if there is an *invisible hand* which steers them so that they will *help others*, even if that was not their intention.



Some people say that when **governments** try to do things for people, an *invisible foot* interferes, so that the outcome is always worse than what the government intended. The results of government welfare over the last 30 years, seem to confirm this suggestion.



Maybe one should view welfare programmes in the same way one looks at a very dangerous drug. Sometimes the drug *may* be necessary to save a patient's life. But, it remains dangerous, and one must use it very carefully, otherwise the patient may become a drug addict.



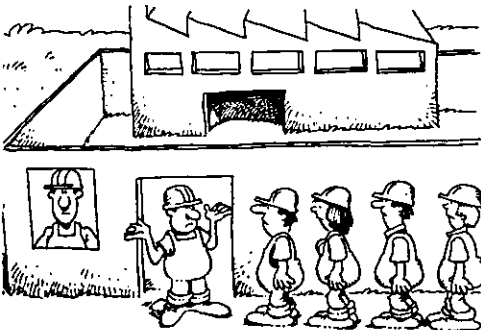
The unintended consequences which government welfare programmes have on people's motivation to work, on the family, on community life, on crime, and on government spending, should make one think carefully before choosing government welfare as a general solution.

So, where does that leave us? Central planning does not work because it leads to the destruction of property rights and the price system.

Government welfare programmes, on the other hand, can very easily lead to many unwanted consequences. And, to make things worse, both central planning and government welfare programmes destroy community functions which are so important for the self-respect of ordinary people.

This does not mean that we should disregard the plight of those unfortunate people who, through no fault of their own, are hungry and homeless. But, in our efforts to help them, we must be very careful not to create a bigger problem than the one we wish to solve.

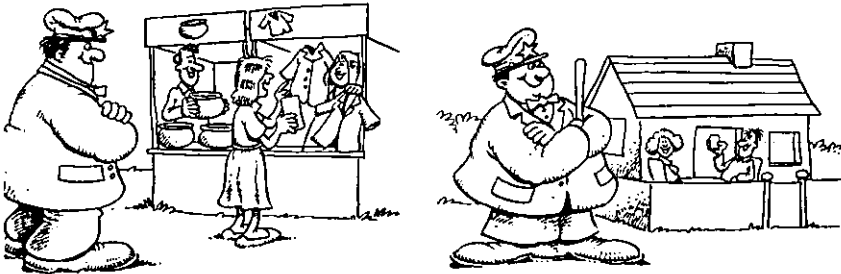
A VIABLE ALTERNATIVE



There are millions of poor people who are constantly looking for opportunities to improve their standard of living, if only they could find them. The question we have to answer, is why aren't those opportunities available? In

fact, can a market economy ever create enough opportunities for everyone?

Maybe we should start by defining a true market economy. Many of the societies which are known by that name, are in fact much closer to centrally planned economies than people realise.



- In a true market economy, the government allows and protects ownership of property and voluntary exchange.
- It creates the framework of peace and stability within which people can play the game of life.
- People can trade with their property and labour in any way they see fit, as long as they do not endanger anybody's safety, damage anyone's property, or act in a fraudulent way.
- In such a society, government plays an important role as the protector of property rights and individual liberty.
- This role does not require a lot of money, and taxes are therefore very reasonable. People spend more time on creating wealth, and less on hiding it from the tax man.
- The government also ensures that the monetary system of the country is sound. With a sound monetary system, there will be no inflation.
- Nobody is granted privileges in the form of special licences, subsidies, tax concessions, import control, tariff protection, and the like.

- There are no unrealistic building regulations, nor restrictions on the subdivision or use of land.
- And, finally, government allows communities a bigger say in their own decisions about the matters which affect them.

How does a market economy affect poor people? Well, poverty is nothing other than *the lack of wealth*.

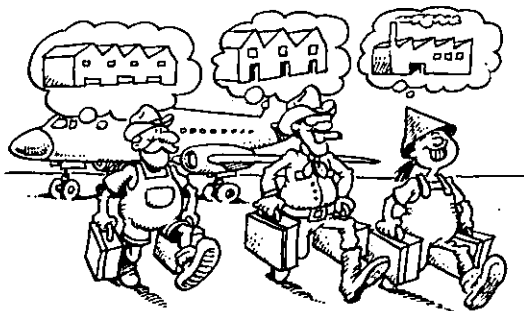
So, let's see if this kind of system will make it possible for poor people to create their own wealth, or to share in the wealth of others.

REDISTRIBUTION THROUGH THE MARKET

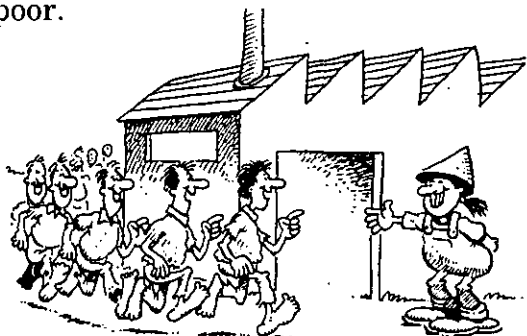
We'll use as an example a country where there is an unequal distribution of wealth, where many people are poor, and where unemployment is high. This is precisely the kind of society which critics of a market economy see as unavoidable, and the reason why they want government to interfere.

If such a country were to introduce a true market economy, then low taxes and cheap labour would soon attract foreign investors to open businesses and factories.

At the same time, local investors would do the same with *their* wealth.



All of them would have purely selfish motives. They would *not* invest money because they wanted to create jobs or help the poor.



But, as Adam Smith said, the *invisible hand* would cause them to benefit others *even if that was not their intention*.

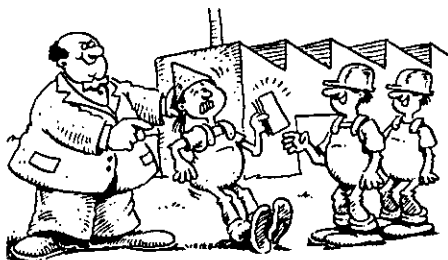
The factories and businesses would require labour. *Some* of the unemployed would find jobs.

The redistribution process of the market economy would begin. Part of the wealth created by the new factories would be redistributed as *wages*.

A very important *learning process* would also be taking place. The workers would acquire new skills and attitudes which they did not have before. Those skills, or human capital, would remain even if the **investors** were to leave.

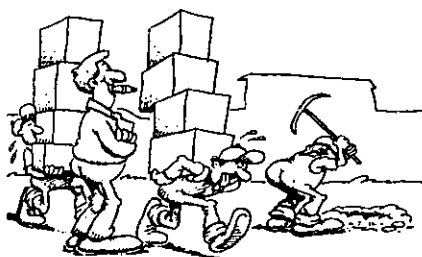
Does the new wealth created make the poor poorer? No. In fact, some of them are now much **wealthier** than before. This is a very important point. In a market economy, the creation of wealth *never* happens at the expense of the poor.

What happens if the government decides to interfere? For example, what if it demands that the investors pay *higher* wages to the workers? Will that benefit the workers?



A few of them *will* benefit. They will get higher wages than they would have received without the help of government. But new investors will immediately act in their own self-interest. They will look for more profitable investments somewhere else. The *process* of wealth creation will slow down or come to an end.

Does this mean a market economy can only create wealth if it allows the *exploitation* of workers who have no other choice than to accept low wages? How can *this* help the poor? Won't they remain poor?

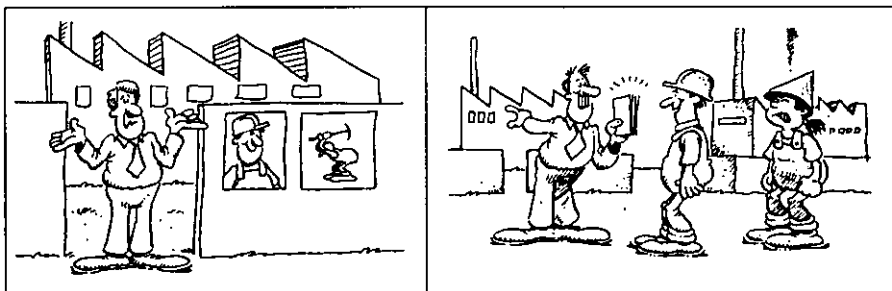


They *will* remain poor for a very short period. However, if the government allows the process to continue without interfering, many *more* investments will be made by local and foreign investors.

Investors *will* get wealthier. But, and this is very important, they never put their profits under their beds. The wealthiest people in the world can only wear so many clothes, or drive so many cars, or have so many homes. What do they do with the *rest* of their wealth?

They continually expand their businesses, or lend their money to others for investment. More jobs are created and better skills acquired.

Before long, the last of the unemployed find jobs and the opportunity for exploitation comes to an end. From that point onwards, any person who requires labour, has to *entice* workers away from other jobs. And that can only be done by either paying higher wages, or by improving working conditions.

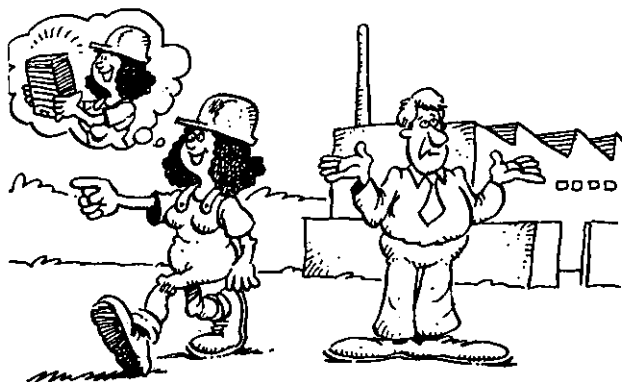


Employers compete continuously for workers and for customers. They want people to buy *their* products or services. This leads to higher wages, - which benefit workers - and to better goods at cheaper prices - which benefit consumers.

Competition also leads to better methods of manufacturing, better tools and machinery, and higher productivity.

CREATING OPPORTUNITIES

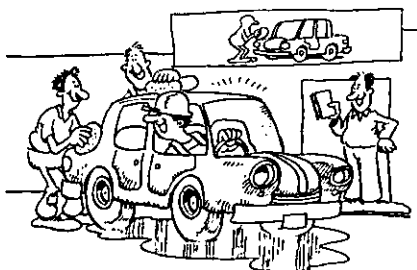
In such a climate of wealth creation, many new opportunities open up for ordinary people. A supervisor in a factory may suddenly realise that she has the skills to compete with her boss because she has thought of a *better* way to make a product.



Or an ordinary worker who has a car may find that there is a demand for a *taxi service*.

The higher wages received by workers allows them to spend money on all kinds of things, like clothes, furniture, houses, medical care, education, toys, and whatever else they may desire.

Small businesses supplying many different services to the community, like dry cleaning, car washing, house building, window cleaning, gardening, painting, and so on, pop up all over the place.



The new wealth is re-distributed through the market process. The owners of land, machinery, and other forms of capital, keep only a portion for themselves. The rest is passed on to workers, suppliers, smaller businesses, hawkers, and to the rest of the community, as people freely exchange their labour and goods with each other.



Some wealth is re-invested in new enterprises, and the cycle of wealth creation continues.

OWNERS AS CARETAKERS

In a market economy, the *owners* of land and capital are like *caretakers*.

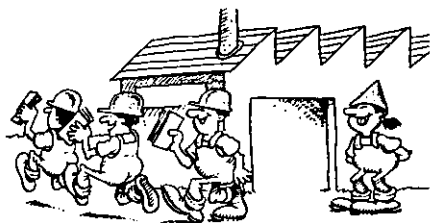
As long as they serve the interests of the public by supplying them with goods and services to their liking, the market allows

them to *keep* or *expand* their wealth. But if they *fail* to do that, consumers will not buy their products and they will *lose* their wealth to somebody else who will use it in the service of consumers.



In a market economy, the consumer is king!! Through their buying or not buying, *the consumers* are continuously determining prices. In this role, they are *directing* the wealth creation process.

Through the price system, *they* determine *what* is to be produced, how *much* is to be produced, and *who* is to produce it. As such, the price system is a much truer reflection of the *will of the people* than any other democratic system. People vote with their money!!



The market economy eliminates poverty because it allows everybody the opportunity to acquire skills, to sell their labour, and to create wealth.

The rich do get richer,.. but only if they serve the interests of the consumer. At the same time, the poor get richer faster.

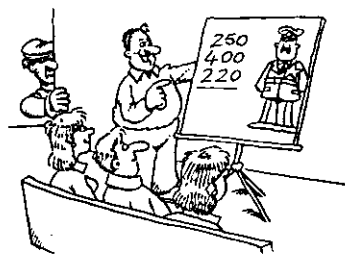
That is, in a market economy, there is an automatic and continuous redistribution of wealth. In fact, research has

shown that, on average, workers receive more than *eight times* as much of an enterprise's profit as the owners.

WELFARE AS A COMMUNITY FUNCTION

Even in a true market economy, there are still those who, through no fault of their own, can just not look after themselves. There are orphans, old people without families, and others. What about them?

Local communities with the power to make their own decisions, will be well aware of their existence, *and will come to their aid*. It is precisely these community functions which satisfy those very important human needs which we mentioned earlier. Citizens take pride in helping their fellow humans.



In such a society, communities play a much bigger role in the schooling of their children, in the safety of their neighbourhoods, and in the care of the elderly. If allowed to do so, they solve their own crime problems, determine their own shop hours, and

set their own building standards.

They frown upon all activities which threaten the safety of their families or their neighbourhoods. And through their disapproval, they exert a powerful influence.



THE BOTTOM LINE

All countries have the potential to eliminate poverty within the lifetime of an average citizen. And wherever one still finds poor people, one should look for the obstacles which *prevent* them from becoming wealthy. One should ask the following questions:

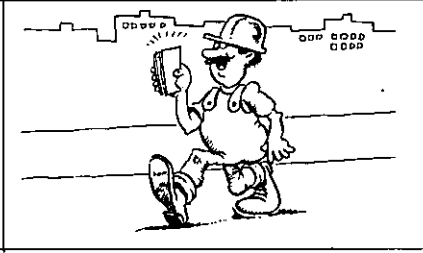
- Does the government allow and protect property rights?
- Does the government allow trade to flow freely, and the price system to operate?
- Does the government have a healthy monetary system so that the price system can be a true reflection of people's choices?
- Does the government allow communities to function independently?

The creation of wealth, the elimination of poverty, and the healthy activities of closely knit communities, can *only* take place if governments *allow* the market economy to work properly.

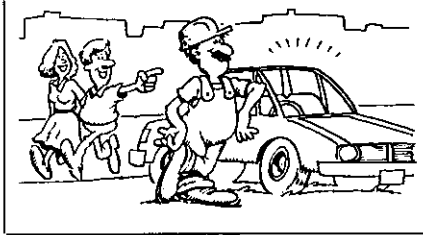
Those who believe that the poor can be helped by centralised planning or by redistributing wealth through government intervention, should learn from history.



The experiences of the last *fifty* years are a grim reminder of our inability to replace property rights and the price system, which have taken more than *fifty thousand* years to evolve.



If we truly want to help the poor, we should allow them the opportunity to help **themselves** under a system which gives them the dignity and esteem deserved by all human beings.



Property rights and the price system are tender flowers which can only grow in a climate of freedom.



Unless we protect them, they will die. And with them, our whole civilization.

PART 3



PROTECTING THE PRINCIPLES

THE REQUIREMENTS FOR PROSPERITY

All people would like to live in a society where no one is poor, and where every citizen is free and prosperous. Unfortunately, very few societies have achieved these ideals.

Experience shows that wealth creation and distribution on a large scale are possible only if individuals have the right to own property, and if the price system is allowed to work. In fact, all societies that have prospered in the past, or are prosperous at present, have protected the private ownership and use of property. This allows individuals to trade, to create wealth, to form voluntary associations, to build communities, to help the poor, and to freely express themselves.

Freedom and prosperity are only possible if our political system protects the principles on which they are built.

How can we protect these principles?

Well, it is basically the job of the State or government. As the servant of the people, it should protect those very important rights that make it possible for people to get on with their lives in a peaceful manner.

And this is where the trouble starts.

It is very easy to say that the government should protect people's rights, but what does this mean? Should such a government





consist of a group of clever people? Should it be a dictatorship? Or must the citizens elect the leaders, that is, should it be a democracy?

If it is democratic, what kind of democracy should it be? A constitutional

democracy, an unlimited democracy, a multi-party democracy, a one-party State, or what?

Should it be a federation? If so, what kind of federation? America, Germany, Switzerland, and India are all federations, but they differ tremendously. What, in fact, is a federation? It soon becomes clear that there are many different political systems in the world. Which one works best?

In this section we will look at some of them. We will see how they work, and whether they can protect those very important rights that are required for peace and prosperity.

NON-DEMOCRATIC FORMS OF GOVERNMENT



Let's first look at non-democratic forms of government. These are systems where the rulers are not chosen by the citizens. Examples are the kingdoms of old, military governments of recent times, one-party dictatorships, and a few colonies.

Can such societies be prosperous?

There is no doubt that some non-democratic societies have been prosperous - at least for a time. But, and this is very important, such periods of prosperity have normally gone hand in hand with the protection of individual property rights. That is, in prosperous countries people usually had the right to own their own land, tools, money, and other possessions, and to use these as they themselves saw fit.

Hong Kong, for example, while being ruled by Britain for a century, had no democratic elections and its laws were not determined by its citizens. Yet, due to the protection of property rights and free trade, it became a very prosperous society.

Does it mean that democracy is not a requirement for prosperity?



Strictly speaking one could have a successful society without a democratic government. All that is required is that the government protect people's right to own and control their own property. However,

experience shows that prosperity never lasts very long under non-democratic governments. These societies inevitably get leaders who interfere with property rights and individual freedom.

DEMOCRACY AND PROSPERITY

What about democratic governments? Are they always prosperous?

No, unfortunately not. Their prosperity depends very much on the **type** of democracy. For example, both India and Switzerland are seen as democracies, but their governments are completely different. Switzerland is very rich while India is generally poor.

So, let's look at the concept of democracy more closely.

The word itself simply means "rule by the people." It is a system where citizens can change their rulers in a peaceful manner. Unfortunately, there are many misconceptions about it. Some people believe that democracy should be unlimited. They believe that any decision taken in a democratic way is always fair. In such an unlimited democracy, they say, these decisions reflect the will of the people. And is this not what democracy is all about?

DEMOCRACY AND THE RULE OF LAW

The Greeks of old, who introduced democracy to the world, definitely did not have such unlimited power in mind. They saw democracy as an instrument that could be used to elect new leaders or to get



rid of unwanted ones in a peaceful way. But that did not mean that such elected leaders could do whatever they wanted, even if they had the support of the majority. The elected leaders, so the Greeks believed, could only do what the law allowed them to do.

Of course, during those times, the word *law* had a very different meaning from the way we use it today. The Greeks believed that laws were rules of behaviour that were not made by anyone. They *developed* or *evolved* over long periods.

As in the case of language, traditions, or the price system, such laws resulted from human action but not from human design. They came about through the daily activities of millions of people who never had the intention of designing a legal system.

This kind of law existed long before governments were even invented. In fact, since the very dawn of mankind, human beings have developed their own traditional rules to live by, without the help of governments. These customary laws have guided people's actions, and have helped them to survive and prosper.

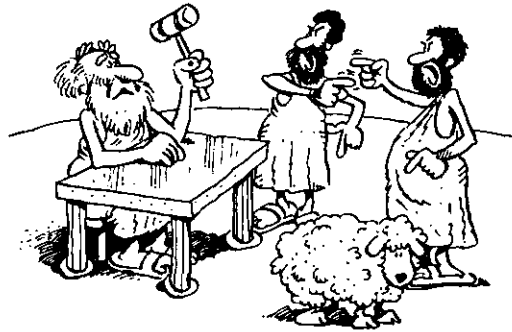


Many people believe that the only reason why societies and governments developed at all, was because people did learn to follow certain general rules of behaviour; rules like honouring agreements, or respecting another person's property.

The Greeks themselves correctly saw that laws existed before governments, and not the other way round.

How did these customary laws develop? Well, suppose two people had a disagreement. They would take their case to a judge, who was sometimes called a 'law-giver' or 'law-speaker.' He would have knowledge of the traditional rules of the people, and would try to discover which rule applied to their specific case. If the case was completely new and the judge could not find such a law, he would use the everyday principles of fairness and justice to make his decision.

This decision would then be used in similar cases in the future. Soon people would begin to view it as another general law of their society. It was, in fact, the task of judges to *discover* such general laws from the people's own rules and customs, and to adapt them to new situations.



In this way, the law did not change every time the government changed, as is so often the case today. It changed only very gradually, over centuries. It became known as the **common law**, showing that it came from the common people. Laws against stealing, murder, assault, and so on, are all part of this common law.

What does this have to do with democracy?

Initially, democracy was seen as a system where elected leaders ruled a country according to the *common law* of the time. The leaders were elected in a democratic way, but they could do only those things that the law allowed them. This was what people meant when they used the expression: the **rule of law**. The rule of law simply meant that everyone, including the government or leaders, had to obey the same rules.

Many of these rules had to do with the protection and transfer of private **property rights**. And this is the main reason why the few societies that were governed by common law, were more successful than their neighbours. Their system of property rights led to the creation of wealth and

to general prosperity.

These societies were far from perfect. Most still practised slavery; they did not allow women to vote; and many people were poor. Even so, they were far better than the brutal dictatorships of the time. During the last few hundred years, however, the word 'democracy' has taken on many different meanings.



DIFFERENT TYPES OF DEMOCRACY

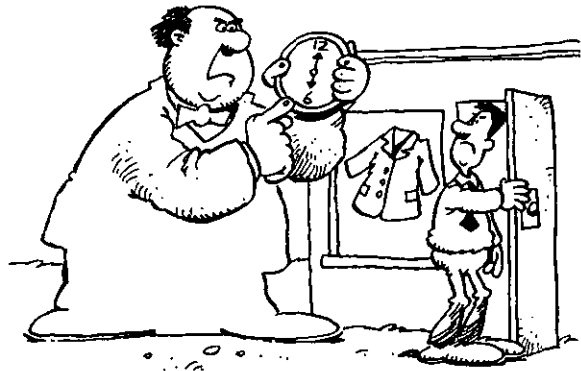
Today, very few people understand what 'common law' or 'the rule of law' mean, or what they have to do with true democracy. Nowadays, most people view democracy as a system where an elected government can make any law it pleases.

This is very different from what the Greeks had in mind when they spoke about democracy. In the past, laws came from the customs and traditions of the people, and could undergo changes only gradually. In modern times, the law

is seen as something made by governments as and when it suits them.

In the past, the common law was a set of rules that prevented people from using force or fraud, and that protected property rights. Such rules had to apply to everyone equally. They were not supposed to discriminate between rich and poor or between leaders and ordinary people.

Nowadays, government-made laws can selectively place burdens on some people and give benefits to others. They can destroy property rights and personal freedom. And they make the phrase *rule of law* meaningless.



Under these conditions, modern democracies can take many shapes, some quite successful, but others very destructive.

So, let's look at some of them.

We'll start with **direct democracy**. Here people can vote directly on the laws themselves. It was popular in earlier societies, where very few cities had more than 10,000 people. Women and slaves did not have the vote, and it was easy for the voting males to meet somewhere, discuss a problem, and vote on it directly.

Today, the closest we come to direct democracy, is during a referendum, when citizens are asked to vote 'yes' or 'no' on a

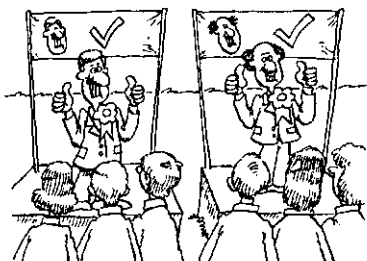
specific issue. Later on, we will discuss the importance of a referendum.



REPRESENTATIVE DEMOCRACY

In modern societies where there are millions of citizens, direct democracy is more difficult. It is not so easy to get everyone in a large country together to vote every time a problem arises. Instead, a country is normally divided into voting regions or electoral districts. People then form political parties that choose or nominate certain individuals to represent them as candidates for particular regions.

Citizens vote for the candidate of their choice. The elected candidates, or representatives, become the government of the country. This is called a **representative government**. The system is called a **representative democracy**.



If a new law is to be passed, all the representatives discuss it, and then they vote on it. If more representatives vote for the law than against it, the new law will be adopted.

In a representative democracy, people do not vote on issues directly, but their chosen representatives do. It is seen as a more practical way for the millions of citizens in modern societies to express their wishes. The political group that has a majority, that is, more than half the representatives in government, usually gets its way.

Many people view this as a very fair way of deciding how a country should be ruled. After all, shouldn't the majority determine the outcome of decisions?

Unfortunately, things do not always work as we intend.

Let's take an example. Imagine a country where each region is represented in government by a democratically elected candidate. What can be fairer than that?

Suppose this country consists of 900 voters, and there are 3 districts or regions. Each region has, say, 300 voters. Let's assume further that there are two political parties, called the red and the green party.

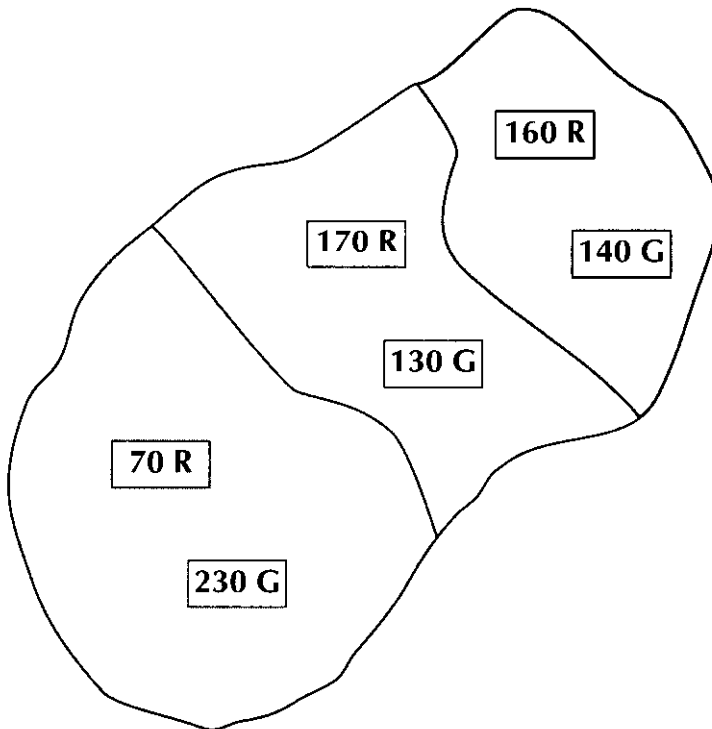
During the election, the voting is as follows: In the first region, 160 people vote for the reds, and 140 for the greens. The candidate of the red party wins. He or she receives the most votes and will thus represent the 300 people of the region in government.

In the second region, 170 people vote for the reds, and 130 for the greens. Here, once again, the red candidate wins, and will represent the citizens.

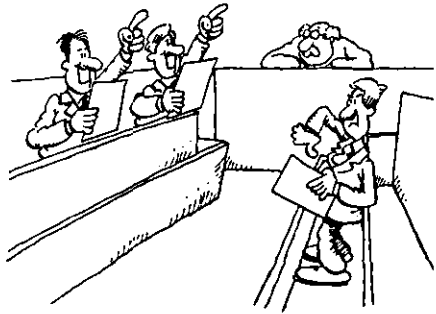
In the third region, things are different. The greens have a runaway victory, and they collect 230 votes against 70 for the reds. The green candidate will represent that region.

This government will now consist of two red candidates and only one green. When they vote, the issues favoured by the reds will be passed, while those favoured by the greens will be turned down. Remember, the reds have the majority in government.

But, if one counts the total number of votes, then it becomes clear that out of the 900 citizens, 400 people voted for the reds against 500 for the greens. That is, more citizens voted for the greens than for the reds.



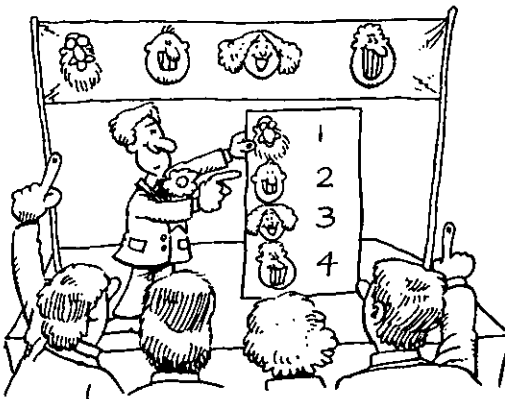
Yet, the reds have more representatives in government, and will effectively rule the country. And what is so democratic about that?



In fact, many ruling governments have discovered that this system can be a clever way to side-step democracy. All one has to do is to subdivide those regions where one has a lot of support into more voting districts. This will give the ruling party more representatives in government.

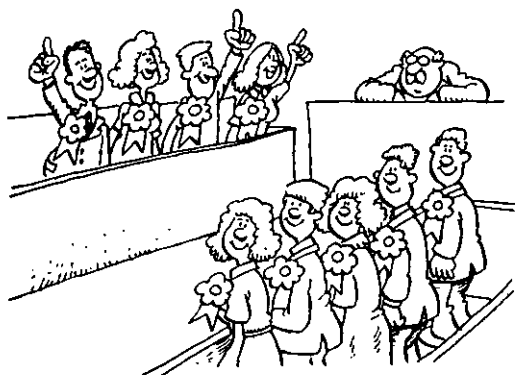
PROPORTIONAL REPRESENTATION

Some countries have tried to overcome this shortcoming of a representative democracy through a system called proportional representation. Under proportional representation, each political party draws up a list of its preferred candidates before an election.



After the election, such parties will be represented in proportion to the support they received. People now vote for a specific party and not for a specific candidate. Such candidates will be taken from a list of names supplied by each of the parties.

In our earlier example, where 400 people voted for the reds and 500 for the greens, and if there is one representative for each 100 voters, 4 representatives will be taken from



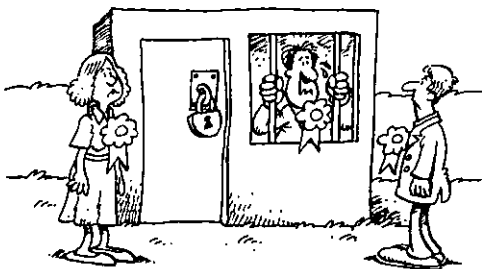
the reds' list, and 5 from the greens'. The greens will now have the majority in government, and not the reds as before.

This is still a representative democracy, but each party is now represented proportionally to the support it has. The main advantage of

proportional representation is that it allows for smaller parties to be represented in government. That is, if people vote for a small party, then, under a system of proportional representation, such a minority will still be represented in government, even if the other parties got most of the votes.

MULTI-PARTY DEMOCRACY

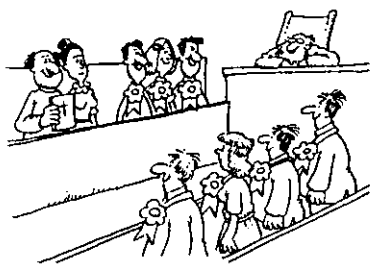
Of course, it is clear that one cannot have such a system in a one-party state, that is, where the government places a ban on all political parties except its own. Proportional representation only works in a **multi-party** democracy, where there is more than one political party competing for the votes of the citizens.



In such a multi-party democracy, we may even find that several parties are represented in government, with no single one having a majority.

Take our earlier example of the country with 900 voters. Say there are now three political parties, the reds, the greens, and the religious party. What happens if, during an election, 300 people vote for the reds, 400 for the greens, and 200 for the religious party?

In a multi-party democracy, based on proportional representation, the reds will have 3 representatives, the greens 4, and the religious party 2. In this government of 9, no party has more than half the representatives. But, any two of them combined will have more than half. They will have a majority.



Such a combination of political parties to form a majority is called a *coalition*.

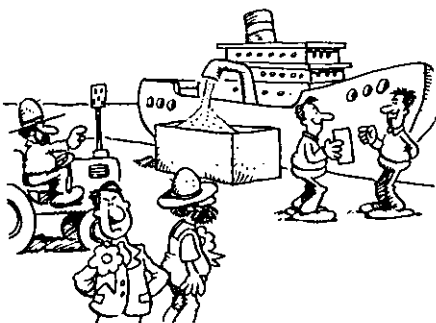
POLITICAL BACKSCRATCHING

Even with proportional representation, representative democracies can still be used for undemocratic ends. For example, if the religious party wants a law passed that will make it illegal to wear certain types of clothing, they may have a



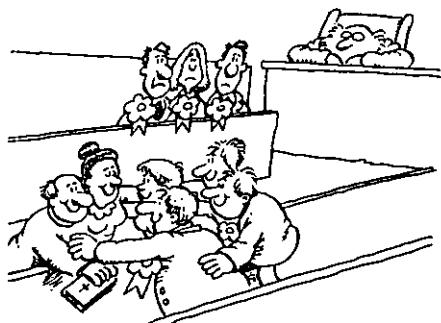
problem. With only 2 candidates out of 9, they will be outvoted every time. It is likely that the majority of the citizens would also be against such a law.

Suppose further that the green party has the support of many farmers. They may want a law that will prevent competition from farmers overseas who would sell their grain more cheaply. But, with only 4 representatives out of 9, they will also be outvoted by the others. The majority of the citizens, on the other hand, would like the benefit of cheaper imported grain.



But, let's see what can happen under this type of representative democracy.

What, for example, will prevent the religious group from going to the greens and suggesting that if they voted with the religious party to make certain types of clothing illegal,



then the religious party would help the greens to prevent the import of cheap grain? You scratch my back and I'll scratch yours. By cooperating with each other, both parties can now get bad laws passed which they could not have done on their own.

This process may have the appearance of democracy, but it is not very democratic at all. A majority of citizens opposes

both laws. If they could have decided themselves, through direct democracy, they would never have voted for these laws.

The problem is that in any modern society, and even within the same political party, there are many different interest groups.

Farmers would like to have subsidies, protection of their markets, and minimum prices for their products.



Manufacturers would like to have import controls and subsidised exports. Trade unions would like to have minimum-wage laws, labour laws, and closed-shop arrangements. Doctors, lawyers,

dentists, accountants, hairdressers, estate agents, and others would like to have the protection of licensing laws. Each of the groups would like to use the political process for special protection, permits, licences, and favours.

THE REFERENDUM

How do we prevent this abuse of democracy by special interest groups? Unfortunately, this is very difficult.

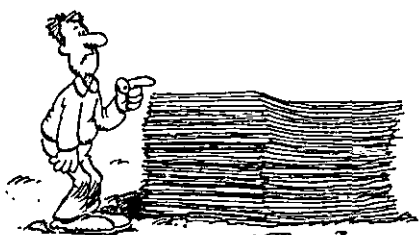
Interest groups are normally well organised. They may use the best lawyers and advocates to state their case, or try to make their causes sound as if the public would benefit from them.





One may even find a group of professional people, called lobbyists, whose job it is to influence politicians, and to arrange deals between them.

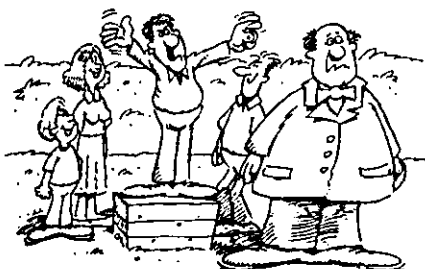
In most democracies of today, thousands of laws are passed that do not benefit the public. In fact, many of the laws lead to higher prices, higher unemployment, higher housing costs, fewer available goods, and a lowering of living standards. But each law benefits some interest group in some way. And what is democratic about that?



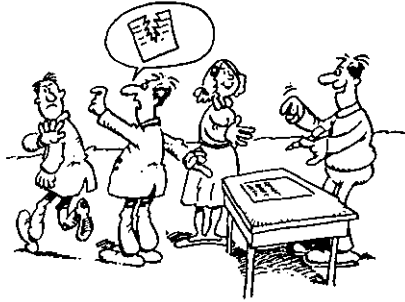
As you can clearly see, a representative democracy is no guarantee that we will not have many unnecessary and unjust laws that benefit only small minorities at the expense of the general public.

And this can be true under a one-party democracy, a multi-party democracy, and under a system of proportional representation.

Is there anything that ordinary people can do to protect themselves against this corruption of the democratic process? Well, what will happen if the citizens themselves have a direct way of removing bad laws? We'll take our 900-citizen society as an example once again. Let's say this society has a political system based on a representative



democracy but with this additional requirement: if a certain percentage, say 10%, of the citizens sign a petition saying they don't like a particular law, then the government has to hold a **referendum**.

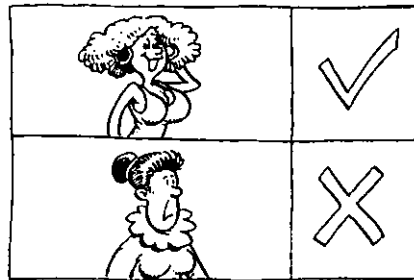


Remember that a referendum is a special election where citizens have to vote either 'yes' or 'no' on a specific issue.

In our imaginary society, you will remember, the religious party wanted a law that would prevent people from wearing certain types of clothing. But, because they only had 2 representatives out of 9, they had to co-operate with the green party that, in turn, wanted a law to protect farmers from foreign competition.

In this way, two bad laws, that benefitted only a minority of citizens, were passed.

Fortunately, with our referendum option, the rest of the citizens can protect themselves. All they have to do, is to get the signatures of 90 people who think the laws are bad. Remember, we said that they needed 10% of the



citizens, that is 90 out of 900, to show disapproval, to force a referendum. Once they can show that at least 90 people are against the laws, the government must hold a referendum where all the voters have to vote 'yes' or 'no' on the two laws. If, in the referendum, more people vote *against* the

laws than for them, they will be scrapped.

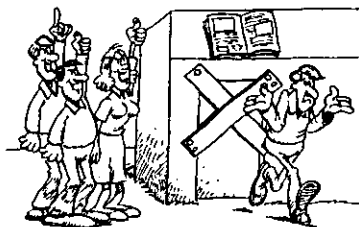
This is called a referendum for scrapping bad laws. It gives the general public the opportunity to remove laws by voting directly against them. It allows the majority to cancel unwanted laws. It is a protection for citizens against small but well-organised minority groups who want to promote their interests at the expense of everyone else's. And it makes politicians more careful not to introduce bad laws.



CAN DEMOCRACY BE UNLIMITED

However, there are still some other problems to solve. For example, what happens if the majority of citizens favours a law that discriminates unfairly against a smaller group?

Can they decide democratically to cut off the left ear of those few individuals who go around spitting on the pavements? Or can they decide democratically to close down those newspapers that criticise the majority? Or democrati-





cally silence small religious groups preaching a faith that differs from the beliefs of the majority?

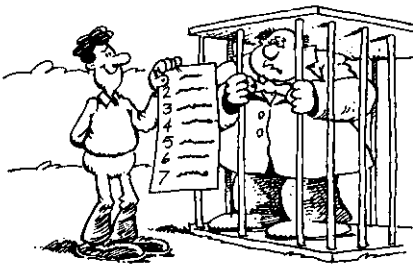
Of course not.

If these things can happen, then such an unlimited democracy could easily lead to the total destruction of the democratic process itself. The majority could then vote to take away everyone else's right to vote!!

CONSTITUTIONAL DEMOCRACIES AND A BILL OF RIGHTS

The truth is that real democracy depends on certain fundamental freedoms. These freedoms include, among others, the right of an individual not to be locked up without a fair trial, the right to vote, the freedom to criticise the government, that is, freedom of speech, and the freedom to choose one's own religion. These freedoms, or *rights*, make democracy possible, and, they need special protection.

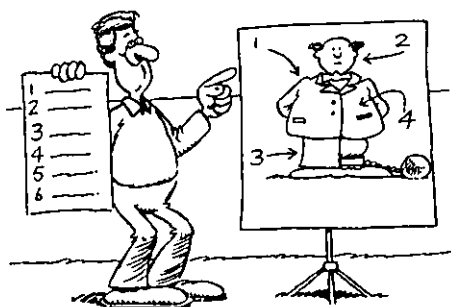
This is done through a document known as a **bill of rights**. It is a list of certain important rights that all citizens are entitled to. A bill of rights places a limit on the power of the



government. It is an acknowledgement that if one wants democracy to be meaningful, then there are certain human activities that governments should leave alone even if the majority wants to interfere.

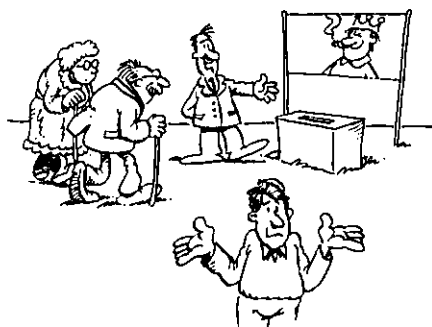
Whereas the referendum protects the majority against special interest groups, a bill of rights protects individuals and smaller groups against the power of government and of the majority.

There is another important document that many people see as essential for a proper democracy - a **constitution**. A constitution contains information about the structure or make-up of a specific government. It is like a recipe that spells out how the government is supposed to function.



A democratic government that functions in terms of a written constitution is called a **constitutional democracy**.

Of course, one can clearly see that if two countries are both constitutional democracies then it still does not mean they have the same political system. Remember, the political system of a constitutional democracy depends entirely on what the constitution actually *says*.



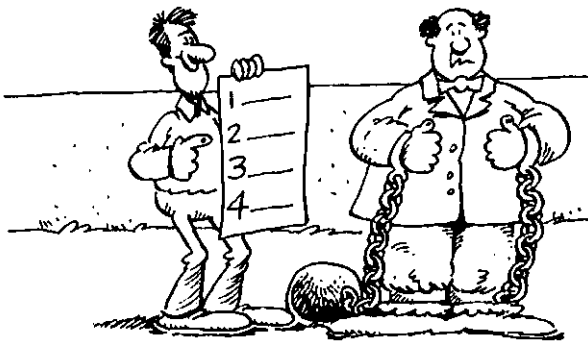
For example, if one country has a constitution that says only citizens over the age of 70 may vote, that the president is elected for life and can make any law he wants to, and that people who are caught stealing must have one of their hands chopped

off, then such a society can certainly be called a constitutional democracy. All the citizens who live long enough, will eventually vote, and the country does have a constitution.

However, none of us would like to live in that society. The fact that a country is a constitutional democracy, is no guarantee that its citizens will be either free or prosperous. Such a constitutional democracy can still be an unlimited democracy and be abused by politicians and special interest groups.

As you can see, a constitution is a very important document. It should contain clear instructions about how the government should function, and what it may and may not do. In fact, it should be like a *job description* for the government. Only then does it have any value.

Just as in the case of a bill of rights, the true function of a proper constitution, is to *limit* the power of a government. It is an effort to force those who rule over us, to do so *justly*, and in terms of certain fixed and known rules spelled out clearly in the constitution.



BI-CAMERAL PROTECTION

Many people will agree that constitutions and bills of rights could be very handy tools to protect all people. But, they say, they are tools made from paper! And what will happen if a government comes to power, and then simply tears up those pieces of paper? What will protect the people then? After all, history has shown that these things do happen.



So, how does one prevent that?

During the last few hundred years, various societies have struggled with this problem. Only some have succeeded in solving it. History shows that all the successful societies have had one thing in common: They all limited or controlled the power of their government. That is, they have all been **limited democracies**.

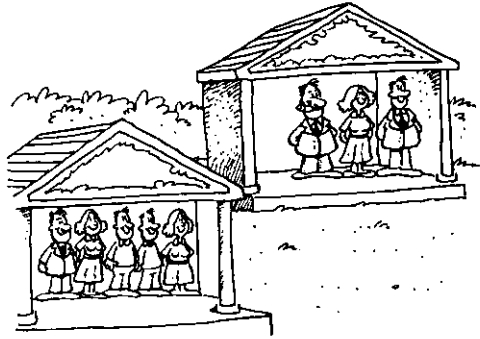
How does one control the power of a government?

Well, many people have realised that constitutional protection is not always enough. Constitutions can be changed or scrapped. Therefore, some additional protection is required for a true and lasting democratic society. That is, there must be other controls or checks and balances in government.

One such extra control is a system of two groups of repre-

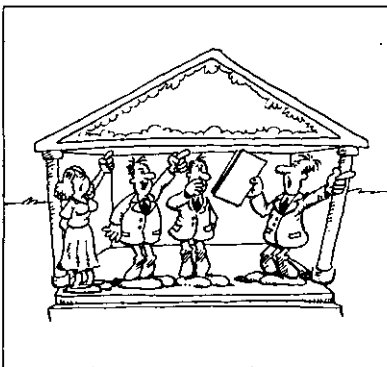
sentatives in government. This is called a **bi-cameral** or a **two-house system**.

The first group is chosen democratically on the basis of one-person-one-vote. This branch of government, is normally called the lower house or house of representatives. It represents the citizens of the country.



The second group, normally called the upper house, may consist of individuals representing specific regions, minorities, or interest groups. This upper house does not represent people in their capacity as individuals, but as members of a specific interest group. Any new law will only be passed if both the lower house and the upper house are in agreement about it.

The main purpose of a bi-cameral system of government, is to make sure that all laws are debated at length by every interest group in that society before it is passed or thrown out. And in some societies the second house is able to *veto*

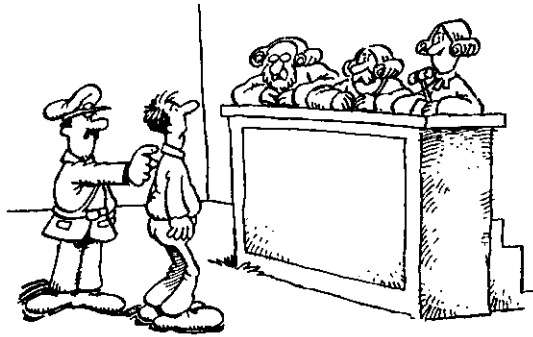


or prevent a law from being passed. A veto can thus be another way of *limiting* the power of a government.

Examples of bi-cameral systems are the U.S.A with its house of representatives and its senate, and Britain with its House of Commons and House of Lords.

PROTECTION THROUGH AN INDEPENDENT JUDICIARY

As another additional safeguard against the abuse of government power, many bi-cameral democracies have decided that the people who *make* the law, should not also be the ones who *interpret* it. That is, the makers of the law should not decide how it should be applied to different cases.



Judges should have the job of interpreting the law. And they should be completely independent of the government that makes the law. In other words, politicians and other members of government should not be the ones who choose judges.

In fact, many people believe that either the citizens themselves should elect judges in the same way that they elect their representatives in government, or that they should be elected by lawyers and advocates who know the specific ability and independence of their own colleagues.

With such an **independent judiciary**, politicians cannot easily influence the interpretation of the law. They cannot get judges to 'bend the law' to favour their supporters.

Of course, it still means that magistrates and judges have to make their findings according to the law. For example, if



it says that anybody caught spitting on the sidewalk should be hanged, then the judge cannot make a decision that is contrary to the law.

Even with an independent judiciary, one can have many unfair laws. Remember, in modern societies, the laws are made by governments, and not by the people as in the case of common law. Today, judges only interpret the law written by politicians.

A bi-cameral system is still open to abuse by powerful interest groups. As we have seen, they can still arrange deals and coalitions between representatives of different parties. And, in spite of an independent judiciary, the citizens may still end up with laws that they themselves would never have voted for.

Any powerful majority can control both houses and pass all kinds of laws that may harm minorities. The referendum that we discussed before will be of no use in such a situation.

PROTECTION THROUGH THE DEVOLUTION OF POWER

In fact, some people believe that it is simply impossible for any central government *not* to make bad laws. Representatives of political parties, they say, can always be

manipulated or bribed to pass laws that benefit minorities and special interest groups. Or, if the country is ruled by a powerful majority, politicians would just ignore the interests of minorities.

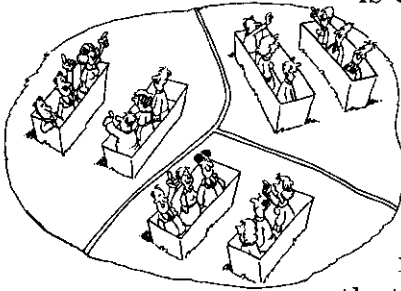


And the only way to overcome this problem, the critics say, is to **decentralise** the power of government. They believe that **devolution of power** through a regional or federal system, is the only solution.

What does this mean?

Well, it simply means that a country consists of certain regions, as in a representative democracy, but that each region can make its own decisions about local issues. Instead of all representatives getting together at central government level to make laws for the whole country, the representatives for a specific region make the laws for the people in that region. Such a system





is called a **federation** or a federal system of regional governments.

The regions can be called federal states or provinces or cantons. The name is not important. But it is important that each region should have its own regional government, elected by the local people, and with the power to decide on local issues.

Another very important requirement is that people are free to move to any area they wish if they are not happy with the policies of their regional government.

There are many federal or regional systems of government in the world, but they differ greatly from each other. In many federations, the central government still has all the power. In these societies, the regions are nothing but geographical areas that make it easy for people to



decide which football or soccer team they support. And that is definitely not the real objective of a federation. Federal societies are only successful if regions have the right to make their own decisions about local issues.

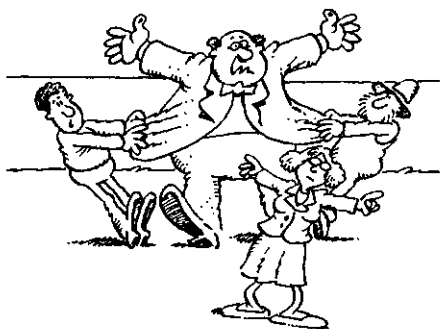
Why should that make them successful?

Well, most societies consist of a mixture of very different people. There are differences of language, ethnicity, culture,

religion, and many, many more.

No politician, however well-meaning, can represent the interests of such a diversity of human beings. A central

government that tries to please all the different people will inevitably become a government of conflict.



Each group will see it as a source of either benefits or oppression. They will constantly try to control the government or to overthrow it.

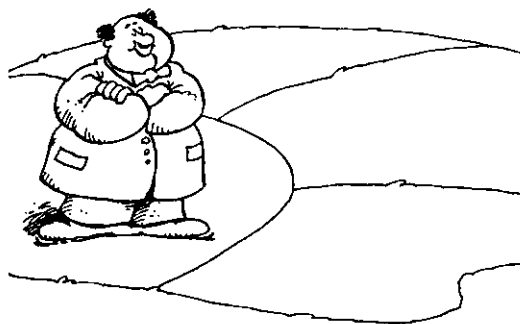
The main advantage of a federation or regional system, is that it allows decision making to be decentralised. This, in turn, allows people with different interests to live in the same unified country, but under laws that they agree with. It makes diversity possible.

Remember, in a federation people can move freely from one region to another. This is very important. It is this freedom of movement that results in healthy competition between the different local governments. If citizens feel that taxes are too high in one region, or that the building regulations are too strict, they can **vote with their feet**. They can move to another area where the rules and regulations are more acceptable.

Of course, one can clearly see that this kind of competition will only be effective if the regions have the right to make their own laws. Only then can some regions have rules that differ from those of other areas.

In some societies, like Switzerland for example, the federal regions are further subdivided into smaller areas where citizens, through their community governments, have a very big say in issues that concern their neighbourhood, town, or city.

As we said before, federal democracies can differ greatly from each other. The type of federation is determined by the degree of decision-making power each region has.



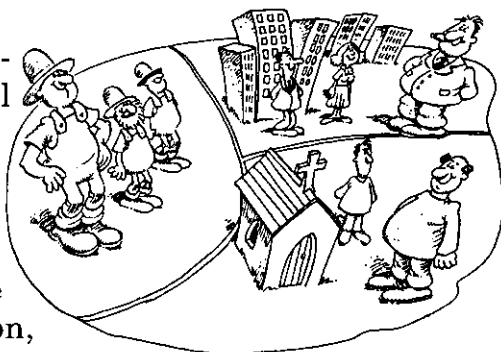
If the central government still makes all the decisions, then a federation is really just a geographic carve-up of a country. In such a federation the government delegates power to the regions to implement

its decisions. The regions, however, have no real power of their own. In the past, the U.S.S.R federation was of this type.

Federal societies where regional and local governments have the power to make their own decisions, are called **devolved federations**. Switzerland is an example of this. Only devolved federations, that is, federations where regional and local governments make their own decisions, can bring peace and unity to multi-cultural societies.

If government power is devolved to community level, it becomes much easier for community organisations to solve the problems of poverty, housing, and crime. At the same time, community involvement brings psychological benefits to individual community members. They feel they have a stake in that society.

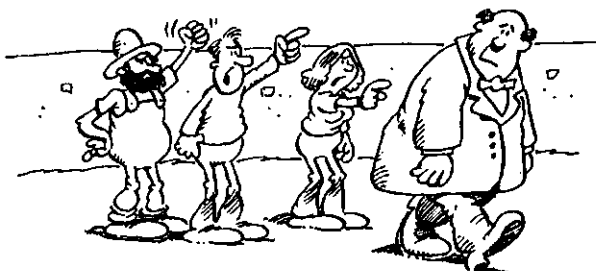
It is only through devolution of power, that natural human diversity can be accommodated voluntarily and peacefully.



In such a society, people are citizens of one nation, but, at the same time, they have the opportunity to live their daily lives as members of a community with common interests.

In their local governments they know their representatives intimately, and they can hold them accountable for their actions and decisions.

A devolved federation restores the power to the people - where it belongs.

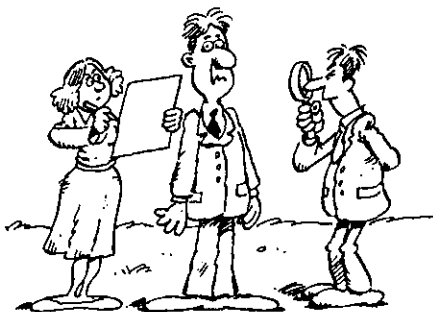


WHICH SYSTEM WORKS BEST?

So far we have seen that not all democratic systems result in prosperity. We have seen how special interest minorities and majorities with unlimited power, can burden us with unwanted laws and violate our rights.

Which type of system then, has the best chance of bringing us prosperity, freedom, and justice?

Well, it should be a system in which everyone can participate, where our fundamental rights as human beings are protected, and where neither minorities nor majorities can use the government to favour themselves at the expense of others.



So, let's see if we can design such an ideal system.

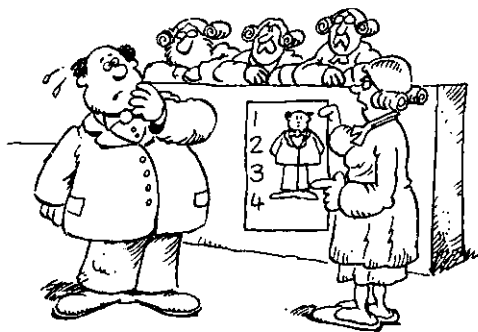
Firstly, we will make it a **multi-party democracy** where competing political parties are allowed, elected on the basis of **proportional representation**, and where every adult citizen can vote.

Then, to prevent abuse by special interest groups or oppressive majorities, we will introduce a **bi-cameral system** of government with a **constitution** and a **bill of rights**.

The bill of rights will guarantee certain individual freedoms, like freedom of speech, religion, and the press, as well as the freedom to own and control property.

The constitution will spell out clearly how the government should function, and what it may and may not do. In this respect, we must remember that those societies where governments are restricted mainly to the protection of person and property are generally the most prosperous.

We will institute a special **constitutional court**, which will see to it that the government does not make any law that violates the terms of the constitution or the bill of rights. The judges of this court will be democratically elected.



In the same way, the rest of the judiciary will also be independent. Its members will not be appointed by politicians, and the government will not be able to overrule their decisions.

As a further safeguard against abuse, we will devolve government power to regional and local levels. We will make sure that local governments have much more decision-making power in their areas than the central government.

At the same time, we will see to it that the constitution guarantees freedom of movement between various regions.

Finally, to make absolutely sure that people are not burdened with unwanted laws, we will make provision for a **referendum** at national, regional and local level. Such a referendum will ensure that the citizens can remove bad

laws, and that politicians are accountable for their actions.

This **constitutional democracy**, with its bill of rights and devolved power structure, will ensure the freedom of every individual. At the same time, it will encourage **diversity** and promote the general welfare.

People will be free to develop and use their talents, to create wealth, and to choose as much or as little diversity in their lives as they care for. The government will be the protector of people, and not their master. It will be impossible to use such a government for personal gain at the expense of others. Its laws will become more and more like the common law of old.

In this society the wealth creation process will be protected and all poverty will soon disappear.

It is important that every citizen in our society becomes aware of these common sense principles of freedom and prosperity. In fact, our future depends on the understanding, acceptance, and implementation of sound economic and political practices.

Only then will there be peace, prosperity, and **justice for all**.

SUMMARY

- Wealth creation depends on some very important general principles which are true for all societies. These principles came about as a result of human action but not through human design. They evolved and were not invented by anyone.
- Individual property rights are the foundations of prosperity. Their evolution resulted in specialisation which led to trade which led to the development of money which led to the development of the price system. This process took many thousands of years.
- The price system became the indispensable tool of wealth creation. It allowed knowledge, which, by its nature, is dispersed in the individual minds of millions of people, to be used efficiently. It works like an enormous information and advice bureau that coordinates the activities and demands of whole populations. It brings about the creation of wealth through production processes of enormous complexity, often beyond human comprehension.
- Societies that allow private property rights and the unhampered development of the price system, are known as market economies.
- Centrally planned societies fail because they tend to destroy property rights and the price system.
- Welfare societies fail because they change the incentive structures of communities. Their unintended

consequences are often worse than the problems they wish to alleviate.

- Both central planning and government welfare tend to destroy important community functions that are essential for human well-being and happiness.
 - True market economies lead to wealth creation as well as wealth redistribution. In fact, all prosperous societies are based on the protection of property rights and the operation of the price system. Only a market economy can eliminate poverty.
 - The political structure of a country has a vital effect on its ability to become prosperous.
 - There are many different kinds of democratic systems. Only some are successful
 - Successful societies are normally multi-party democracies with a constitution and bill of rights that limit the power of the central government. They also have various checks and balances like an independent judiciary, a constitutional court, and a two-house system of government. They normally devolve power to regions, and encourage community involvement in local affairs. Most importantly, they place a very high value on property rights and individual liberty.
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WEALTH CREATION

All societies have the potential to eliminate poverty, and to be peaceful and prosperous. Why then, is there so much misery in the world?

The truth is that any country can become successful *provided* it adheres to the principles of wealth creation.

What are these principles and why do they work? This book explains them sensibly and simply.

The principles of wealth creation were not *invented* by clever individuals, learned councils or farsighted governments. They *evolved* over time – through human action but not through human design. Their development was mostly accidental. And it is only by looking *back* that we can discover what they are and why they work. We can then create the proper political framework within which their application will automatically lead to prosperity.

Readers of this book will have a much better understanding of what economics and politics are all about. And, most importantly, they will be able to make informed decisions about the future society they choose.

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