

# The Virtues of Free Enterprise: *Justice, Prosperity, and Peace*

## *The* **MORALITY** *of* **CAPITALISM**



What Your Professors Won't Tell You

**INCLUDING:**

MARIO VARGAS LLOSA, NOBEL LAUREATE IN LITERATURE

VERNON SMITH, NOBEL LAUREATE IN ECONOMICS

JOHN MACKAY, CO-FOUNDER OF WHOLE FOODS MARKET

EDITED BY TOM G. PALMER



Institut  
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*Des idées pour enrichir le Québec*

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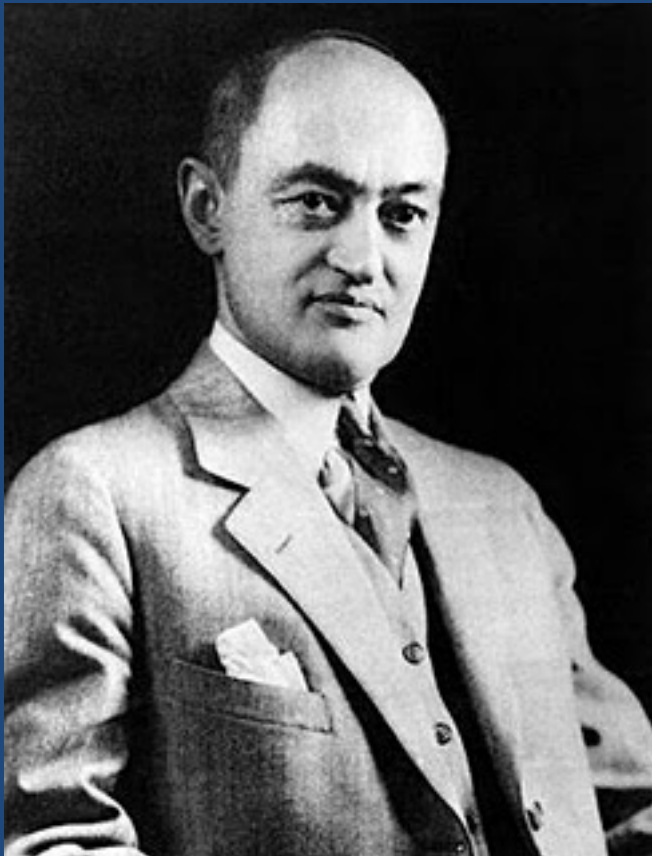
# A Note About Terms

- Free Enterprise
  - Free Markets
  - “Capitalism”

# So... What Is “Free Enterprise” (or “Capitalism”?)

- “...that subspecies of all the systems characterized by private property, which carries out new combinations of factors of production and involving the creation of credit...” **Joseph Schumpeter**, “Can Capitalism Survive?”
- “...a system in which private individuals take initiatives with their own capital to – usually to enhance production, but to produce something that they can sell on the market for a profit...” **Joyce Appleby**, interviewed on her new book *The Relentless Revolution: A History of Capitalism*
- “. . . private property and free labor without central planning, regulated by the rule of law and by ethical consensus;” “*the age of innovation*,” **Deirdre McCloskey**, *Bourgeois Dignity*
- It is an economic system...
- ...a legal system...
- ...a cultural/social system...of relentless innovation resting on equality of well defined and legally secure rights (including “careers open to talent”) and on decentralized innovation and processes of trial and error through the voluntary processes of market exchange

Modern free-markets are characterized by what the economist Joseph Schumpeter called “creative destruction.”



- “the problem that is usually being visualized is how capitalism administers existing structures, whereas the relevant problem is how it creates and destroys them.”

– Joseph Schumpeter, *Capitalism, Socialism, and Democracy*

But Free Enterprise Is More than  
merely Well Defined, Legally Secure,  
and Transferable Property

- It also entails a Culture of
  - Entrepreneurship
  - Innovation (“Openness to the Future”)
  - Service & Adding Value

# Moral Foundations of Free Enterprise

- Based on
  - Property in One's Person
  - Property in One's Freedom (including Freedom of Contract)
  - Property in One's Estate, characterized by the "Three D's"
    - Definable
    - Defendable
    - Divestible
  - Rule of Law

# But first.....

- Is Free Enterprise/Capitalism on Trial? Is it Responsible for the Financial Crisis?





BANK FOR INTERNATIONAL SETTLEMENTS

# *Capitalism on Trial: Is It Responsible for the Present Crisis?*



We make home possible®

# *Are these the Institutions of "Capitalism"?*





# Free Enterprise

VS.

## Cronyism (or “Crony Capitalism”)

- Many complaints about “capitalism” are not about free enterprise, but about cronyism and privilege
- Cronyism is a feature of interventionism, of the exercise of state power to secure special privileges for some at the expense of others, to block competition, to confiscate wealth, and to secure the interests of those with access to political power

# Discourse about Capitalism has been **Poisoned** : Some Common (Mis)conceptions about Free Enterprise

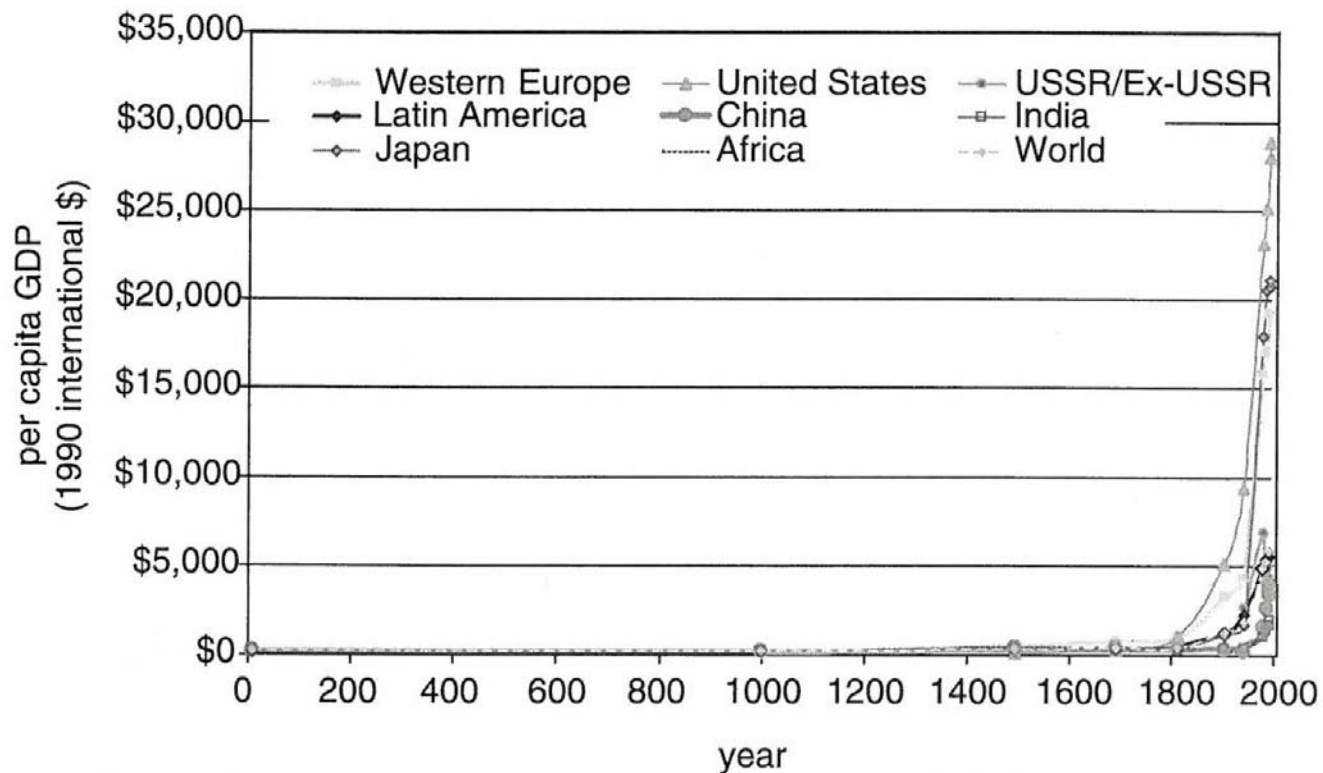
- Competition
  - Opposite of Cooperative: “Dog Eat Dog,” “Cutthroat”
  - OR: *Competition in order to Cooperate*
- Exchange
  - “Selfish,” “Greedy”
  - OR: *Mutually Beneficial*
- Profit
  - “Obscene,” “Windfall”
  - OR: *Measures of value added*

# So...what has free enterprise achieved?

- Let's start by looking at how much the world has changed in recent years
- Then let's measure the degree of economic freedom in the world today and see what we find

# Let's start at the beginning: The Natural Condition of Humanity is Poverty

Figure 2.13  
GLOBAL ECONOMIC DEVELOPMENT, A.D. 1–2003



SOURCES: Angus Maddison, *The World Economy: Historical Statistics* (Paris: OECD, 2003), [www.ggdc.net/~maddison](http://www.ggdc.net/~maddison) (accessed July 30, 2005); Groningen Growth and Development Centre, Total Economy database, <http://www.ggdc.net>.

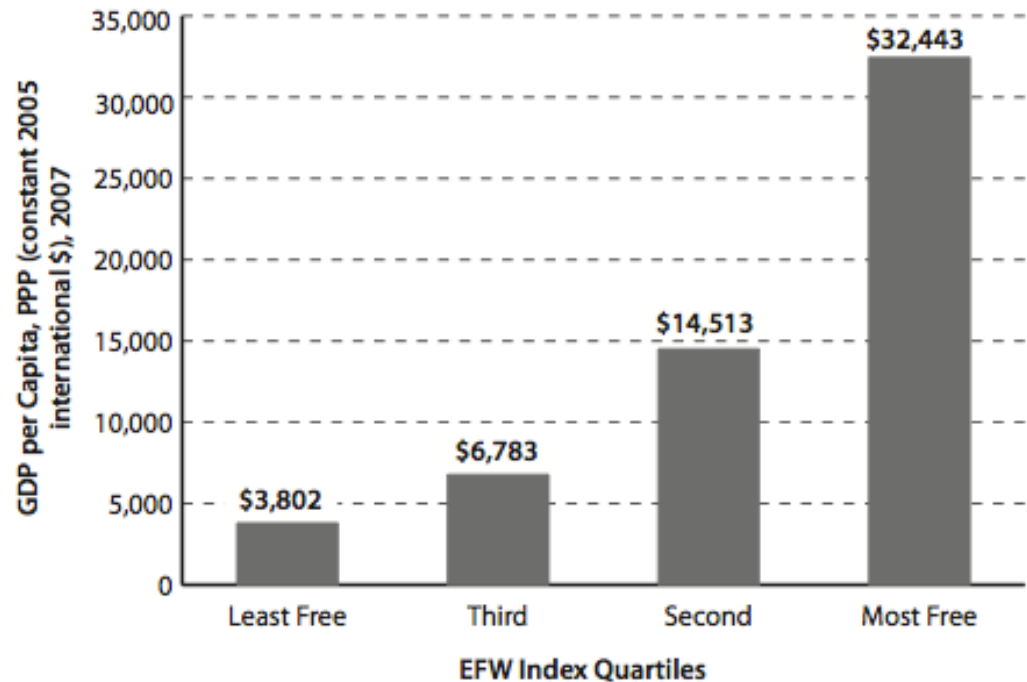


[www.freetheworld.com](http://www.freetheworld.com)

### Exhibit 1.6: Economic Freedom and Income per Capita

*Countries with more economic freedom have substantially higher per-capita incomes.*

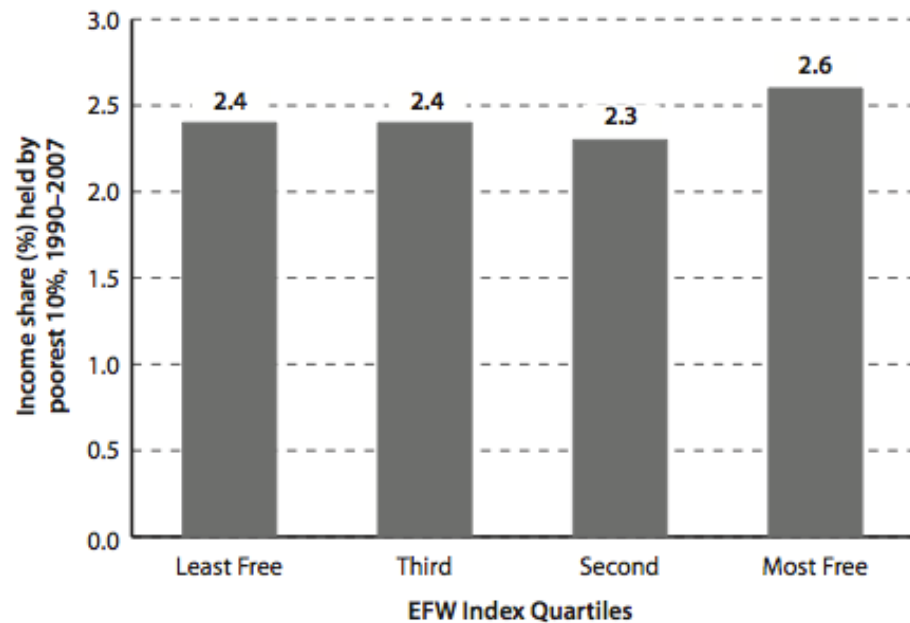
Sources: Fraser Institute; World Bank, *World Development Indicators*,  
<<http://go.worldbank.org/U0FSM7AQ40>>,  
<<http://go.worldbank.org/1SF48T40L0>>.



### Exhibit 1.10: Economic Freedom and the Income Share of the Poorest 10%

*The share of income earned by the poorest 10% of the population is unrelated to the degree of economic freedom in a nation.*

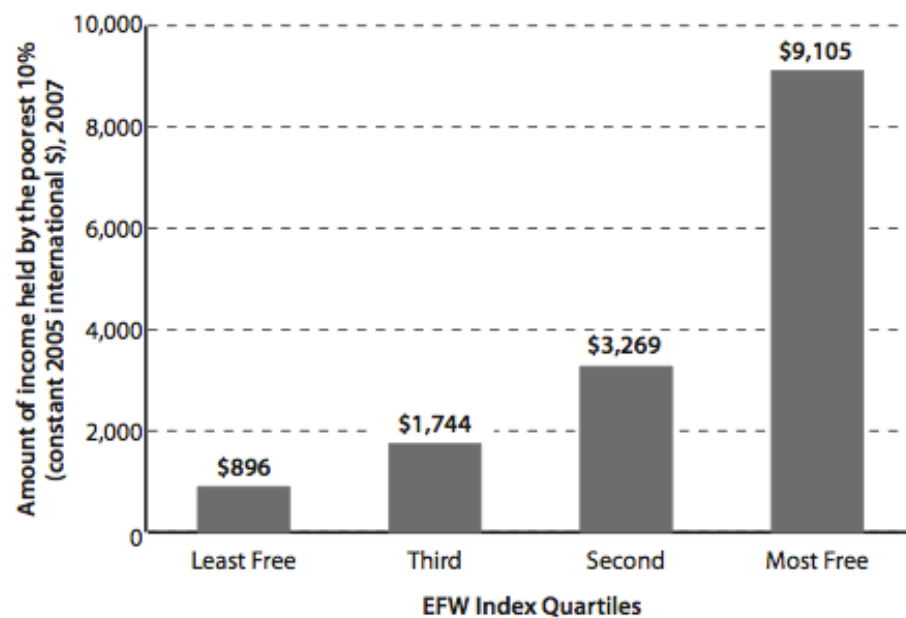
Sources: Fraser Institute; World Bank, *World Development Indicators*,  
<<http://go.worldbank.org/U0FSM7AQ40>>,  
<<http://go.worldbank.org/1SF48T40L0>>.



### Exhibit 1.11: Economic Freedom and the Income Level of the Poorest 10%

*The amount per capita, as opposed to the share, of income going to the poorest 10% of the population is much greater in nations with the most economic freedom than it is in those with the least.*

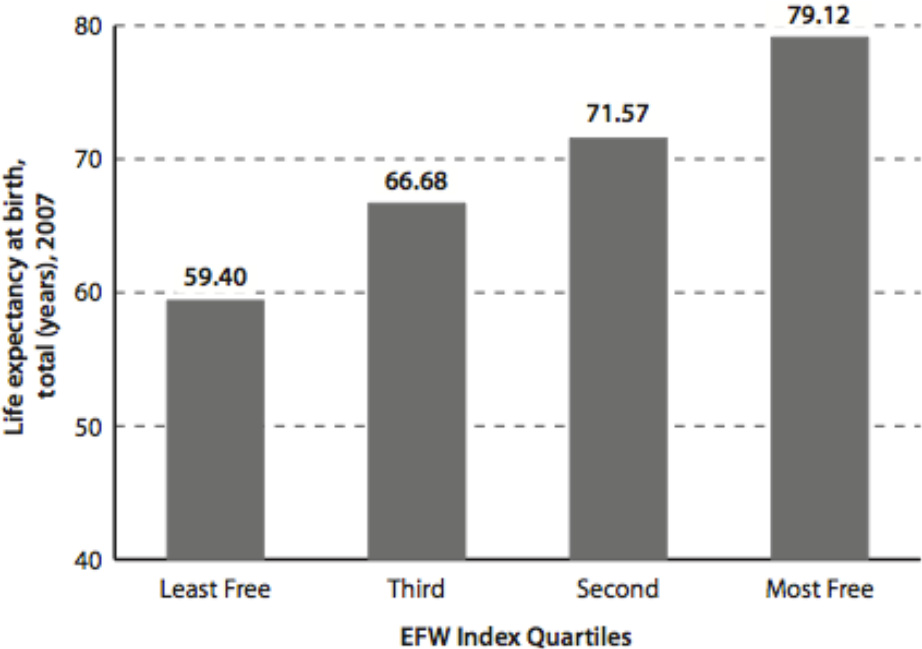
Sources: Fraser Institute; World Bank, *World Development Indicators*,  
<<http://go.worldbank.org/U0FSM7AQ40>>,  
<<http://go.worldbank.org/1SF48T40L0>>.



**Exhibit 1.12: Economic Freedom and Life Expectancy**

*Life expectancy is over 20 years longer in countries with the most economic freedom than it is in those with the least.*

Sources: Fraser Institute; World Bank, *World Development Indicators*, <http://go.worldbank.org/U0FSM7AQ40>, <http://go.worldbank.org/1SF48T40L0>.



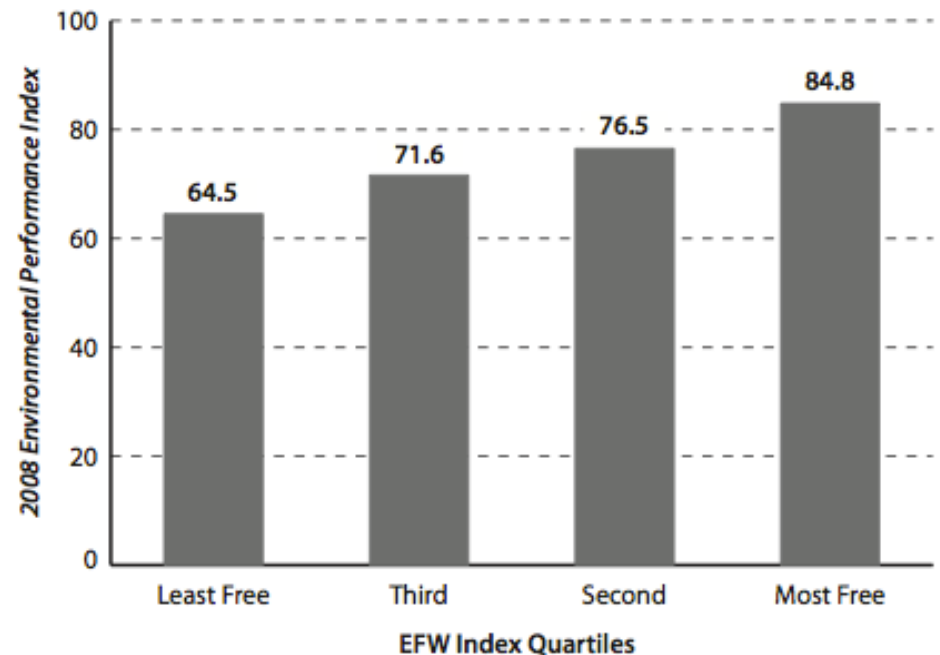


### Exhibit 1.13: Economic Freedom and Environmental Performance

*Environmental stresses on human health are lower and ecosystem vitality is greater in countries with more economic freedom.*

Note: Higher index values (out of 100) indicate greater environmental performance.

Sources: The Fraser Institute; Yale Center for Environmental Law and Policy (YCELP) and Center for International Earth Science Information Network (CIESIN), Columbia University, with the World Economic Forum, and Joint Research Centre (JRC) of the European Commission, *2008 Environmental Performance Index*, <<http://sedac.ciesin.columbia.edu/es/epi/>>.

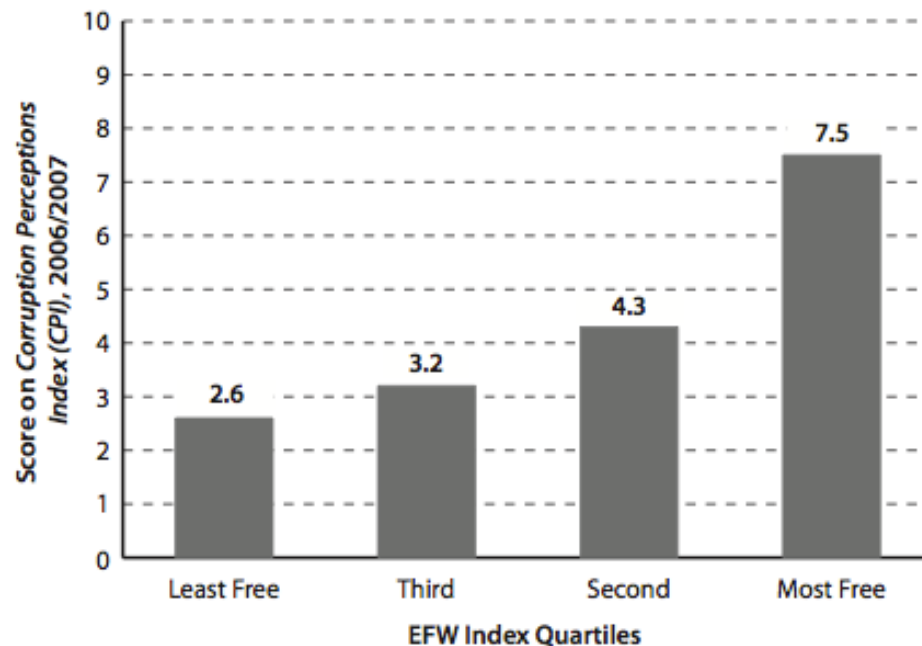


### Exhibit 1.14: Economic Freedom and Corruption

*With fewer regulations, taxes, and tariffs, economic freedom reduces the opportunities for corruption on the part of public officials.*

Note: "CPI Score relates to perceptions of the degree of corruption as seen by business people and country analysts, and ranges between 10 (highly clean) and 0 (highly corrupt)."

Sources: Fraser Institute; Transparency International, *Corruption Perceptions Index 2007*, <[http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/2007/](http://www.transparency.org/policy_research/surveys_indices/cpi/2007/)>.



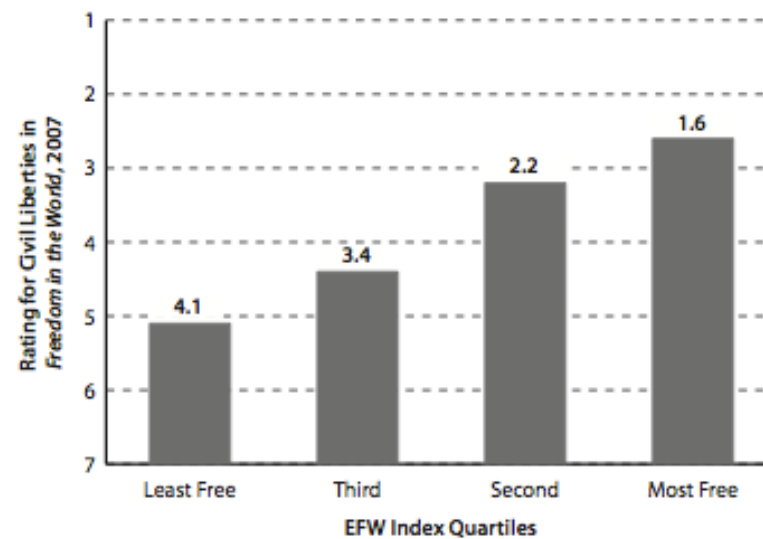
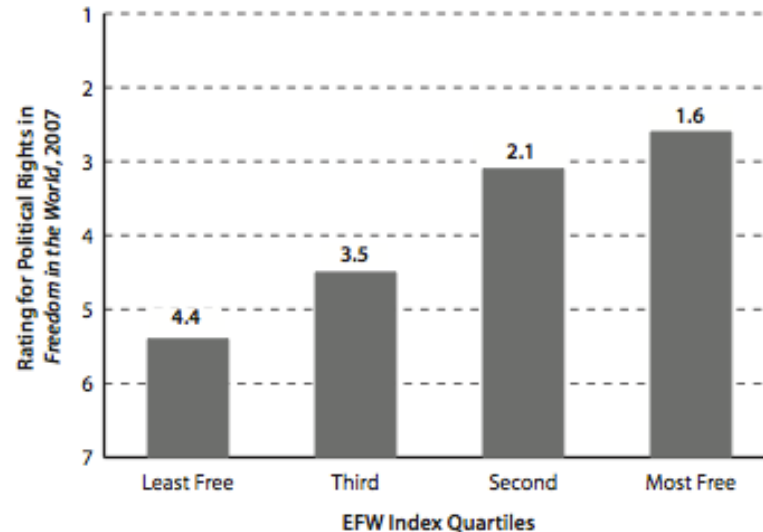
### Exhibit 1.15: Economic Freedom and Political Rights and Civil Liberties

*Political rights (e.g., free and fair elections) and civil liberties (e.g., freedom of speech) go hand in hand with economic freedom.*

Note: Political rights and civil liberties are measured on a scale from 1 to 7: 1 = the highest degree of political rights and civil liberties; 7 = the lowest.

*The Freedom in the World survey provides an annual evaluation of the state of global freedom as experienced by individuals. The survey measures freedom—the opportunity to act spontaneously in a variety of fields outside the control of the government and other centers of potential domination—according to two broad categories: political rights and civil liberties. Political rights enable people to participate freely in the political process, including the right to vote freely for distinct alternatives in legitimate elections, compete for public office, join political parties and organizations, and elect representatives who have a decisive impact on public policies and are accountable to the electorate. Civil liberties allow for the freedoms of expression and belief, associational and organizational rights, rule of law, and personal autonomy without interference from the state.”* <<http://www.freedomhouse.org/template.cfm?page=35&year=2006>>

Sources: The Fraser Institute; Freedom House, *Freedom in the World Comparative and Historical Data*, <<http://www.freedomhouse.org/template.cfm?page=439>>.



# Say's Law of Markets: Free Enterprise Morality, Friendship, and Peace

- “Each individual is interested in the general prosperity of all, and the success of one branch of industry promotes that of all the others...The position of a nation, in respect of its neighbors, is analogous to the relation of one of its provinces to the others, or of the country to the town; it has an interest in their prosperity, being sure to profit by their opulence.”

—Jean-Baptiste Say



## Freedom of Trade Creates Interests for Peace.....

“The international interconnection of the interests resulting from freedom of trade is the most effective means for the prevention of war. Had we advanced so far as to see a good customer in every foreigner, there would be much less inclination to shoot at him....”

John Prince Smith, member of the German Reichstag  
1860

# The Capitalist Trading Peace

## The Capitalist Peace

Erik Gartzke Columbia University

*It is widely accepted that democracies are less conflict prone, if only with other democracies. Debate persists, however, about the causes underlying liberal peace. This article offers a contrarian account based on liberal political economy. Economic development, free markets, and similar interstate interests all anticipate a lessening of militarized disputes or wars. This "capitalist peace" also accounts for the effect commonly attributed to regime type in standard statistical tests of the democratic peace.*

### Which Liberal Peace?

The discovery that democracies seldom fight each other has led, quite reasonably, to the conclusion that democracy causes peace, at least within the community of liberal polities. Explanations abound, but a consensus account of the dyadic democratic peace has been surprisingly slow to materialize. I offer a theory of liberal peace based on capitalism and common interstate interests. Economic development, capital market integration, and the compatibility of foreign policy preferences supplant the effect of democracy in standard statistical tests of the democratic peace. In fact, after controlling for regional heterogeneity, any one of these three variables is sufficient to account for effects previously attributed to regime type in standard samples of wars, militarized interstate disputes (MIDs), and fatal disputes.<sup>1</sup>

If war is a product of incompatible interests and failed or absorptive bargaining, peace ensues when states lack differences worthy of costly conflict, or when circumstances favor successful diplomacy. Realists and others argue that state interests are inherently incompatible, but this need be so only if state interests are narrowly defined or when consequent promises tangible benefits. Peace can result from at least three attributes of mature capitalist economies.

First, the historic impetus to territorial expansion is tempered by the rising importance of intellectual and financial capital, factors that are more expeditiously enticed than conquered. Land does little to increase the worth of the advanced economies while resource competition is more cheaply pursued through markets than by means of military occupation. At the same time, development actually increases the ability of states to project power when incompatible policy objectives exist. Development affects who states fight (and what they fight over) more than the overall frequency of warfare. Second, substantial overlap in the foreign policy goals of developed nations in the post-World War II period further limits the scope and scale of conflict. Lacking territorial tensions, consensus about how to order the international system has allowed liberal states to cooperate and to accommodate minor differences. Whether this affinity among liberal states will persist in the next century is a question open to debate. Finally, the rise of global capital markets creates a new mechanism for competition and communication for states that might otherwise be forced to fight. Separately, these processes influence patterns of warfare in the modern world. Together, they explain the absence of war among states in the developed world and account for the dyadic observation of the democratic peace.

Erik Gartzke is associate professor of political science and a member of the Saltzman Institute of War and Peace Studies. Email: gartzke@columbia.edu. Web: www.columbia.edu/~eg569. Comments are welcome and appreciated.

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<sup>1</sup>Additional tests of key variables, model specifications, and possible confounding factors appear in the appendix. A Stata "do" file replicating all aspects of the analysis is available from the author.

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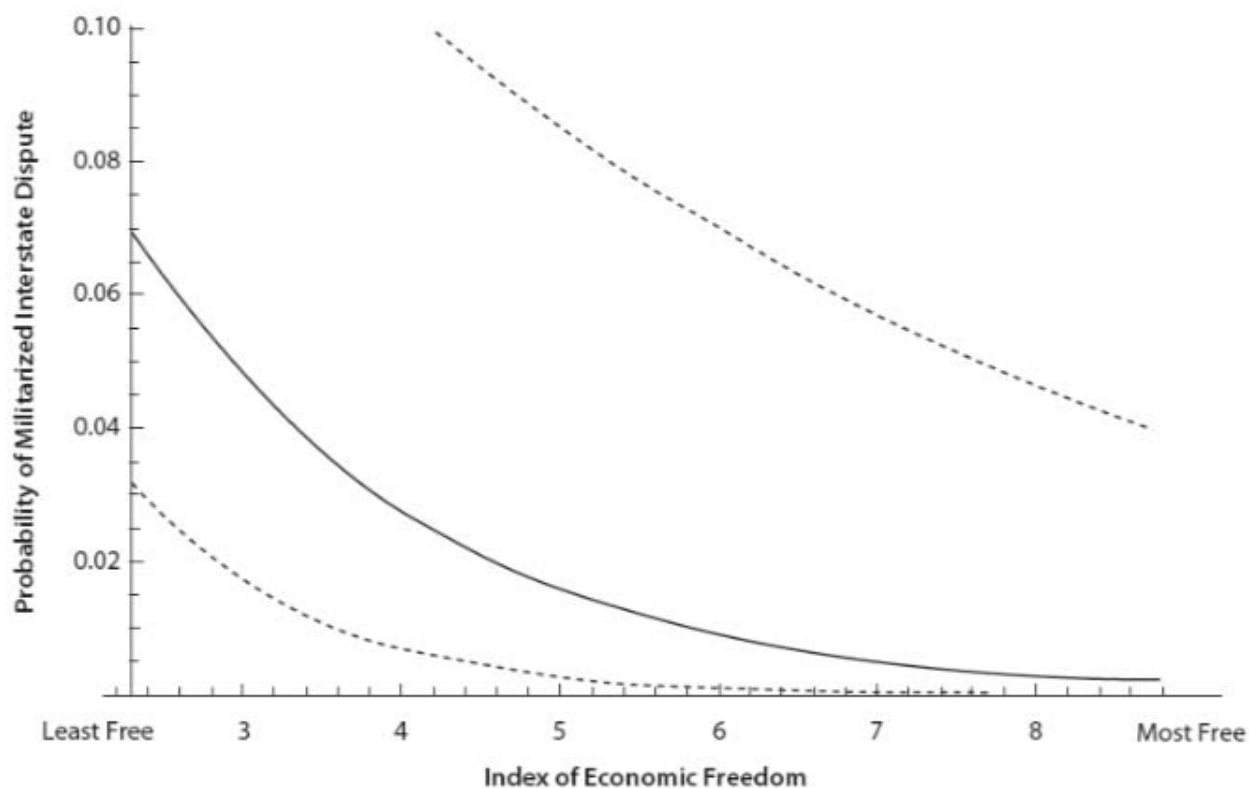
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- As Erik Gartzke has shown, the well studied “democratic peace” is really the “capitalist peace.” Nations that trade are less likely to go to war.
  - Erik Gartzke
  - *American Journal of Political Science*, Vol. 51, No. 1, January 2007, Pp. 166–191

# Evidence: Economic Freedom and Peace

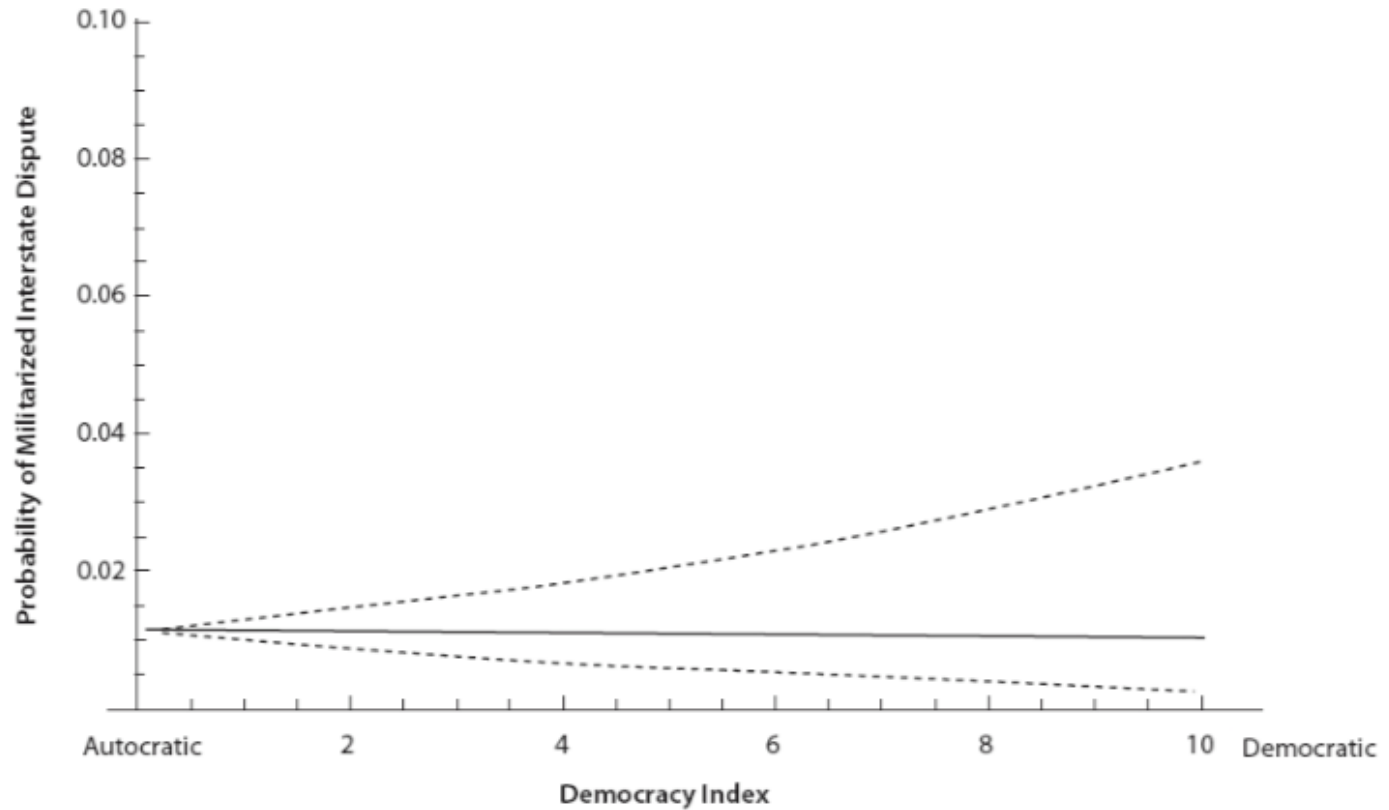
Figure 2.1: Effect of Economic Freedom on Militarized Interstate Disputes (MIDs)



Source: Table 2.1.

# Evidence: Democracy and Peace

Figure 2.2: Effect of Democracy on Militarized Interstate Disputes (MIDs)





Democracy is favorable for peace,  
but it is even more favorable to peace when  
democracies embrace free trade

# Commerce Civilizes Us



“For the Cyclops have no  
ships with crimson prows

No shipwrights there to  
build them good strong  
craft

That could sail them out  
to foreign ports of call  
As most men risk the seas  
to trade with other men.”

-- Homer, *The Odyssey*