CENTRAL ECONOMIC PLANNING

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"Free Enterprise was born with man and shall survive as long as man survives."

—**A. D. Shroff**
1899-1965
Founder-President
Forum of Free Enterprise

INTRODUCTION

Long before he was awarded the Nobel Prize for economics, Prof. Milton Friedman was renowned all over the world for his studies in monetary economics. His contributions are so profound and original, that a school of thought in economics named Friedmanism has developed in the last few years. Prof. Friedman is not only an original thinker, but also lucid in his exposition, in writing as well as speaking. The Forum of Free Enterprise has had the privilege of publishing his booklets several years ago and also presenting him on Forum platform. in Bombay.

His recent publication "Freedom to Choose", co-authored with his wife, Rose Friedman, who is also a distinguished economist, has been a best-seller. It is aimed to give the layman an understanding of economic phenomena and an idea of correct policy measures on current issues like inflation, controls, taxation etc.

Prof. Friedman, who keenly appreciates the work of the Forum of Free Enterprise in educating Indian public in economic affairs, readily granted to Forum permission to publish excerpts from this book, and arranged with the publishers, Harscourt Brace Jovanovich, Inc. to grant the necessary permission. The Forum is deeply grateful to Prof. Friedman, Rose Friedman, and the publishers.

Readers are strongly recommended to read the original in full, now available in paperback edition(AVON BOOKS).

CENTRAL ECONOMIC PLANNING*

By

Prof. Milton Friedman &
Rose Friedman

Travelling in underdeveloped countries, we have over and over again been deeply impressed by the striking contrast between the ideas about facts held by the intellectuals of those countries and many intellectuals in the West, and the facts themselves.

Intellectuals everywhere take for granted that free enterprise capitalism and a free market are devices for exploiting the masses, while central economic planning is the wave of the future that will set their countries on the road to rapid progress. We shall not soon forget the tongue-lashing one of us received from a prominent, highly successful and extremely literate Indian entrepreneur—physically the very model of the Marxist caricature of an obese capitalist—in reaction to remarks that he correctly interpreted as criticism of India's detailed central planning. He informed us in no uncertain terms that the government of a country as poor as India simply had to control imports, domestic production, and the allocation of investment—and by implication, grant him the special privileges in all these

* This excerpt from a chapter of FREE TO CHOOSE by Milton and Rose Friedman is published by special arrangement with Harcourt Brace Jovanovich, Inc.;

areas that are the source of his own affluence—in order to assure that social priorities override the selfish demands of individuals. And he was simply echoing the views of the professors and other intellectuals in India and elsewhere.

The facts themselves are very different. Wherever we find any large element of individual freedom, some measure of progress in the material comforts at the disposal of ordinary citizens, and widespread hope of further progress in the future, there we also find that economic activity is organised mainly through the free market. Wherever the state undertakes to control in detail the economic activities of its citizens, wherever, that is, detailed central economic planning reigns, there ordinary citizens are in political fetters, have a low standard of living, and have little power to control their own destiny. The state may prosper and produce impressive monuments. Privileged classes may enjoy a full measure of material comforts. But the ordinary citizens are instruments to be used for the state's purposes, receiving no more than necessary to keep them docile and reasonably productive.

The most obvious example is the contrast between East and West Germany, originally part of one whole, torn asunder by the vicissitudes of warfare. People of the same blood, the same civilization, the same level of technical skill and knowledge inhabit the two parts. Which has prospered? Which had to erect a wall to pen in its citizens? Which must man it today with armed guards, assisted by fierce dogs, minefields, and similar devices of devilish ingenuity in order to frustrate brave and desperate citizens who are willing to risk their lives to leave their communist paradise for the capitalist hell on the other side of the wall ?

On one side of that wall the brightly lit streets and stores are filled with cheerful, bustling people. Some are shopping for goods from all over the globe. Others are going to the numerous movie houses or other places of entertainment. They can buy freely newspapers and magazines expressing every variety of opinion. They speak with one another or with strangers on any subject and express a wide range of opinions without a single backward glance over the shoulder. A walk of a few hundred feet, after an hour spent in line, filling in forms and waiting for passports to be returned, will take you, as it took us to the other side of the wall. There, the streets appear empty; the city, gray and pallid; the store windows, dull; the buildings, grimy. Wartime destruction has not yet been repaired after more than three decades. The only sign of cheerfulness or activity that we found during our brief visit to East Berlin was at the entertainment center. One hour in East Berlin is enough to understand why the authorities put up the wall.

It seemed a miracle when West Germany—a defeated and devastated country—became one of the strongest economies on the continent of Europe in less than a decade. It was the miracle of a free market. Ludwig Erhard, an economist, was the German Minister of Economics. On Sunday, the twentieth of June 1948, he simultaneously introduced a new currency, today's Deutsche mark, and abolished almost all controls on wages and prices. He acted on a Sunday, he was fond of saying, because the offices of the French, American, and British occupation authorities were closed that day. Given their favourable attitudes toward controls, he was sure that if he had acted when the offices were open, the occupation authorities would have countermanded his orders. His measures worked like a charm. Within days the shops were full of goods. Within months the German economy was humming away.

Even two communist countries, Russia and Yugoslavia, offer a similar, though less extreme, contrast. Russia is closely controlled from the centre. It has not been able to dispense wholly with private property and free markets, but it has tried to limit their scope as much as possible. Yugoslavia started down the same road. However, after Yugoslavia under Tito broke with Stalin's Russia, it changed its course drastically. It is still communist, but deliberately promotes decentralization and the use of market forces. Most agricultural land is privately owned, its produce sold on relatively free markets. Small enterprises (those that have fewer than five employees) may be privately owned and operated. They are flourishing particularly in handicrafts and tourism. Larger enterprises are workers' cooperatives—an inefficient form of organization but one that at least provides some opportunity for individual responsibility and initiative. The inhabitants of Yugoslavia are not free. They have a much lower standard of living than the inhabitants of neighbouring Austria or other similar Western countries. Yet Yugoslavia strikes the observant traveller who comes to it from Russia, as we did, as a paradise by comparison.

In the Middle East, Israel, despite an announced socialist philosophy and policy and extensive government intervention into the economy, has a vigorous market sector, primarily as an indirect consequence of the importance of foreign trade. Its socialist policies have retarded its economic growth, yet its citizens enjoy both more political freedom and a far higher standard of living than the citizens of Egypt, which has suffered from a much more extensive centralization of political power and which has imposed much more rigid controls on economic activity.

In the Far East, Malaysia, Singapore, Korea, Taiwan, Hong Kong and Japan—all relying extensively on private markets are thriving. Their people are full of hope. An economic explosion is under way in these countries. As best such things can be measured, the annual income per person in these countries in the late 1970s ranged from about $ 700 in Malaysia to about $ 5,000 in Japan. By contrast, India, Indonesia, and Communist China, all relying heavily on central planning, have experienced economic stagnation and political repression. The annual income per person in those countries was less than $ 250.

The intellectual apologists for centralized economic planning sang the praises of Mao's China until Mao's successors trumpeted China's backwardness and bemoaned the lack of progress during the past twenty-five years. Part of their design to modernize the country is to let prices and markets play a larger role. These tactics may produce sizable gains from the country's present low economic level—as they did in Yugoslavia. However, the gains will be severely limited so long as political control over economic activity remains tight and private property is narrowly limited. Moreover, letting the genie of private initiative out of the bottle even to this limited extent will give rise to political problems that, sooner or later, are likely to produce a reaction toward greater authoritarianism. The opposite outcome, the collapse of communism and its replacement by a market system, seems far less likely though as incurable optimists, we do not rule it out completely.

An especially illuminating example, worth examining in greater detail, is the contrast between the experiences of India and Japan—India during the first thirty years after it achieved independence in 1947, and Japan not today but during the first thirty years after Meiji Restoration in 1867. Economists and social scientists in general can seldom conduct controlled experiments of the kind that are so important in testing hypotheses in the physical sciences. However, experience has here produced something very close to a controlled experiment that we can use to test the importance of the difference in methods of economic organization.

There is a lapse of eight decades in time. In all other respects the two countries were in similar circumstances at the outset of the periods we compare. Both were countries with ancient civilizations and a sophisticated culture. Each had a highly structured population. Japan had a feudal structure with daimyos (fuedal lords) and serfs. India had a rigid caste system with Brahmans at the top and the untouchables, designated by the British the "scheduled castes", at the bottom.

Both countries experienced a major political change that permitted a drastic alteration in political, economic and social arrangements. In both countries a group of able, dedicated leaders took power. They were imbued with national pride and determined to convert economic stagnation into rapid growth, to transform their countries into great powers.

Almost all differences favoured India rather than Japan

The prior rulers of Japan had enforced almost complete isolation from the rest of the world. International trade and contact was limited to one visit from one Dutch ship a year. The few Westerners permitted to stay in the country were confined to a small enclave on an island in the harbour of Osaka. Three or more centuries of enforced islolation had left Japan ignorant of the outside world, far behind the West in science and technology, and with almost no one who could speak or read any foreign language other than Chinese.

India was much more fortunate. It had enjoyed substantial economic growth before World War I. That growth was converted into stagnation between the two world wars by the struggle for independence from Britain, but was not reversed. Improvements in transportation had ended the localized famines that had earlier been a recurrent course. Many of its leaders had been educated in advanced countries of the West, particularly in Great Britain. British rule left it with a highly skilled and trained civil service, modern factories, and an excellent railroad system. None of these existed in Japan in 1867. India was technologically backward compared to the west, but the differential was less than that between Japan in 1967 and the advanced countries of that day.

India's physical resources, too, were far superior to Japan's. About the only physical advantage Japan had was the sea, which offered easy transportation and a plentiful supply of fish. For the rest, India is nearly nine times as large as Japan, and a much larger percentage of its area consists of relatively level and accessible land. Japan is mostly mountainous. It has only a narrow fringe of the habitable and arable land along the seacoasts.

Finally, Japan was on its own. No foreign capital was invested in Japan; no foreign governments or foreign foundations in capitalist countries formed consortiums to make grants or offer low-interest loans to Japan. It had to depend on itself for capital to finance its economic development. It did have one lucky break. In the early years after the Meiji Restoration, the European silk crops experienced a disastrous failure that enabled Japan to earn more foreign exchange by silk exports than she otherwise could have. Aside from that, there were no important fortuitous or organized sources of capital.

India fared far better. Since it achieved independence in 1947, it has received an enormous volume of resources from the rest of the world, mostly as gifts. The flow continues today.

Despite the similar circumstances of Japan in 1867 and India in 1947, the outcome was vastly different. Japan dismantled its feudal structure and extended social and economic opportunity to all its citizens. The lot of the ordinary man improved rapidly, even though population exploded. Japan became a power to be reckoned with on the international political scene. It did not achieve full individual human and political freedom, but it made great progress in that direction.

India paid lip service to the elimination of caste barriers yet made little progress in practice. Differences in income and wealth between the few and the many grew wider, not narrower. Population exploded, as it did in Japan eight decades earlier, but economic output per capita did not. It remained nearly stationary. Indeed the standard of life of the poorest third of the population has probably declined. n the aftermath of British rule, India prided itself on being the largest democracy in the world, but it lapsed for a time into a dictatorship that restricted freedom of speech and press.

What explains the differences in results ? Many observers point to different social institutions and human characteristics. Religious taboos, the caste system, a fatalistic philosophy—all these are said to imprison the inhabitants of India in a straitjacket of tradition. The Indians are said to be unenterprising and slothful. By contrast, the Japanese are lauded as hardworking, energetic, eager to respond to influences from abroad, and incredibly ingenious at adapting what they learn from outside to their own needs.

This description of the Japanese may be accurate today. It was not in 1867. An early foreign resident in Japan wrote : "Wealthy we do not think it (Japan) will ever become. The advantages conferred by Nature, with exception of the climate, and the love of indolence and pleasure of the people themselves forbid it. The Japanese are a happy race, and being content with little are not likely to achieve much." Wrote another: "In this part of the world, principles, established and recognized in the West, appear to lose whatever virtue and vitality they originally possessed and to tend fatally toward weediness and corruption."

Similarly, the description of the Indian may be accurate today for some Indians in India, even perhaps for most, but it certainly is not accurate for Indians, who have migrated elsewhere. In many African countries, in Malaysia, Hong Kong, the Fiji Islands, Panama, and most recently Great Britain, Indians are successful enterpreneurs, sometimes constituting the mainstay of the entrepreneurial class. They have often been the dynamo initiating and promoting economic progress. Within India itself, enclaves of enterprise, drive, and initiative exist wherever it has been posible to escape the deadening hand of government control.

In any event, economic and social progress do not depend on the attributes or behaviour of the masses. In every country a tiny minority sets the pace, determines the course of events. In the countries that have developed most rapidly and successfully, a minority of enterprising and risk-taking individuals have forged ahead, created opportunities for imitators to follow, have enabled the majority to increase their productivity.

The characteristics of the Indians that so many outside observers deplore reflect rather than cause the lack of progress. Sloth and lack of enterprise flourish when hard work and the taking of risks are not rewarded. A fatalistic philosophy is an accommodation to stagnation. India has no shortage of people with the qualities that could spark and fuel the same kind of economic development that Japan experienced after 1867, or even that Germany and Japan did after World War II. Indeed, the real tragedy of India is that it remains a subcontinent teeming with desperately poor people when it could, we believe, be a flourishing, vigorous, increasingly prosperous and free society.

We recently came across a fascinating example of how an economic system can affect the qualities of people. Chinese refugees who streamed into Hong Kong after the communists gained power sparked its remarkable economic development and gained a deserved reputation for initiative, enterprise, thrift, and hard work. The recent liberalisation of emigration from Red China has produced a new stream of immigrants from the same racial stock, with the same fundamental cultural traditions, but raised and formed by thirty years of communist rule. We hear from several firms that hired some of these refugees that they are very different from the earlier Chinese entrants into Hong Kong. The new immigrants show little initiative and want to be told precisely what to do. They are indolent and uncooperative. No doubt a few years in Hong Kong's free market will change all that.

What then accounts for the different experiences of Japan from 1867 to 1897 and of India from 1947 to date? We believe that the explanation is the same as for the difference between West and East Germany, Israel and Egypt, Taiwan and Red China. Japan relied primarily on voluntary cooperation and free markets—on the model of Britain of its time. India relied on central economic planning—on the model of the Britain of its time.

The Meiji government did intervene in many ways and played a key role in the process of development. It sent many Japanese abroad for technical training. It imported foreign experts. It established pilot plants in many industries and gave numerous subsidies to other. But at no time did it try to control the total amount or direction of investment or the structure of output. The state maintained a large interest only in shipbuilding and iron and steel industries that it thought necessary for military power. It retained these industries because they were not attractive to private enterprise and required heavy government subsidies. These subsidies were a drain on Japanese resources. They impeded rather than stimulated Japanese economic progress. Finally, an international treaty prohibited Japan during the first three decades after the Meiji Restoration from imposing tariffs higher than 5 percent. This restriction proved an unmitigated boon to Japan, though it was resented at the time, and tariffs were raised after the treaty prohibitions expired.

India is following a very different policy. Its leaders regard capitalism as synonymous with imperialism, to be avoided at all costs. They embarked on a series of Russian-type five-year plans that outlined detailed programmes of investment. Some areas of production are reserved to government; in others private firms are permitted to operate, but only in conformity with the Plan. Tariffs and quotas control imports, subsidies control exports. Self-sufficiency is the ideal. Needless to say, these measures produce shortages of foreign exchange. These are met by detailed and extensive foreign exchange control—a major source both of inefficiency and of special privilege. Wages and prices are controlled. A government permit is required to build a factory or to make any other investment. Taxes are ubiquitous, highly graduated on paper, evaded in practice. Smuggling, black markets, illegal transactions of all kinds are every bit as ubiquitous as taxes, undermining all respect for law, yet performing a valuable social service by offsetting to some extent the rigidity of central planning and making it possible for urgent needs to be satisfied.

Reliance on the market in Japan released hidden and unsuspected resources of energy and ingenuity. It prevented vested interests from blocking change. It forced development to conform to the harsh test of efficiency. Reliance on government controls in India frustrates initiative or diverts it into wasteful channels. It protects vested interests from the forces of change. It substitutes bureaucratic approval for market efficiency as the criterion of survival.

The experience in the two countries with homemade and factorymade textiles serves to illustrate the difference in policy. Both Japan in 1867 and India in 1947 had extensive production of textiles in the home. In Japan foreign competition did not have much effect on home production of silk, perhaps because of Japan's advantage in raw silk reinforced by the failure of the European crop, but it all wiped out the home spinning of cloth and later the hand-loom weaving of cotton cloth. A Japanese factory textile industry developed. At first, it manufactured only the coarsest and lowest-grade fabrics, but then moved to higher and higher grades and ultimately became a major export industry.

In India, handloom weaving was subsidized and guaranteed a market, allegedly to ease the transition to factory production. Factory production is growing gradually but has been deliberatley held back to protect the handloom industry. Protection has meant expansion. The number of handlooms roughly doubled from 1948 to 1978. Today, in thousands of villages throughout India, the sound of handlooms can be heard from early morning to late at night. There is nothing wrong with a handloom industry, provided it can compete on even terms with other industries. In Japan a prosperous, though extremely small, handloom industry still exists. It weaves luxury silk and other fabrics. In India the handloom industry prospers because it is subsidized by the government. Taxes are, in effect, imposed on people who are no better off than the ones who operate the looms in order to pay them a higher income than they could earn in a free market.

Early in the nineteenth century, Great Britain faced precisely the same problem that Japan did a few decades later and India did more than a century later. The power-loom threatened to destroy a prosperous handloom weaving industry. A royal commission was appointed to investigate the industry. It considered explicitly the policy followed by India : subsidizing handloom weaving and guaranteeing the industry a market. It rejected that policy out of hand on the ground that it would only make the basic problem, an excess of handloom weavers, worse —precisely what happened in India. Britain adopted the same solution as Japan—the temporarily harsh but ultimately beneficient policy of letting market forces work.

The contrasting experiences of India and Japan are interesting because they bring out so clearly not only the different results of the two methods of organization but also the lack of relation between objectives pursued and policies adopted. The objectives of the new Meiji rulers—who were dedicated to strengthening the power and glory of their country and who attached little value to individual freedom—were more in tune with the Indian policies than those they themselves adopted. The objectives of the new Indian leaders—who were ardently devoted to individual freedom—were more in tune with the Japanese policies than with those they themselves adopted.

CONTROLS AND FREEDOM

Though the United States has not adopted central economic planning, we have gone very far in the past fifty years in expanding the role of government in the economy. That intervention has been costly in economic terms. The limitations imposed on our economic freedom threaten to bring two centuries of economic progress to an end. Intervention has also been costly in political terms. It has greatly limited our human freedom.

The United States remains a predominantly free country —one of the freest major countries in the world. However in the words of Abraham Lincoln's famous "House Divided" speech, "A house divided against itself cannot stand.. I do not expect the house to fall, but I do expect it will cease to be divided. It will become all one thing or all the other." He was talking about human slavery. His prophetic words apply equally to government intervention into the economy. Were it to go much further, our divided house would fall on the collectivist side. Fortunately, evidence grows that the public is recognizing the danger and is determined to stop and reverse the trend toward ever bigger government.

All of us are affected by the *status quo*. We tend to take for granted the situation as it is, to regard it as the natural state of affairs, especially when it has been shaped by a series of small gradual changes. It is hard to appreciate how great the cumulative effect had been. It takes an effort of the imagination to get outside the existing situation and view it with fresh eyes. The effort is well worth making. The result is likely to come as a surprise, not to say a shock.

ECONOMIC FREEDOM

As essential part of economic freedom is freedom to choose how to use our income : how much to spend on ourselves and on what items; how much to save and in what form; how much to give away and to whom. Currently, more than 40 per cent of our income is disposed of on our behalf by government at federal, state, and local levels combined. One of us once suggested a new national holiday, "Personal Independence Day—that day in the year when we stop working to pay the expenses of government...and start working to pay for the items we severally and individually choose in light of our own needs and desires." In 1929 that holiday would have come on Abraham Lincoln's birthday, February 12; today it would come about May 30; if present trends were to continue, it would coincide with the other Independence Day, July 4 around 1988.

Of course, we have something to say about how much of our income is spent on our behalf by government. We participate in the political process that has resulted in government's spending an amount equal to more than 40 percent of our income. Majority rule is a necessary and desirable expedient. It is, however, very different from the kind of freedom you have when you shop at a supermarket. When you enter the voting booth once a year, you almost always vote for a package rather than for specific items. If you are in a majority, you will at best get both the items you favoured and the ones you opposed but regarded as on balance less important. Generally, you end up with something different from what you thought you voted for. If you are in a minority, you must conform to the majority vote and wait for your turn to come. When you vote daily in the supermarket, you get precisely what you voted for, and so does everyone else. The ballot box produces conformity without unanimity; the marketplace, unanimity without conformity. That is why it is desirable to use the ballot box, so far as possible only for those decisions where conformity is essential.

As consumers, we are not even free to choose how to spend the part of our income that is left after taxes. We are not free to buy cyclamates or laetrile and soon, perhaps, saccharin. Our physician is not free to prescribe many drugs for us that he may regard as the most effective for our ailments, even though the drugs may be widely available abroad. We are not free to buy an automobile without seat belts, though, for the time being, we are still free to choose whether or not to buckle up.

Another essential part of economic freedom is freedom to use the resources we possess in accordance with our own values—freedom to enter any occupation, engage in any business enterprise, buy from and sell to anyone else, so long as we do so on a strictly voluntary basis and do not resort to force in order to coerce others.

Today you are not free to offer your services as a lawyer, a physician, a dentist, a plumber, a barber, a mortician, or engage in a host of other occupations without first getting a permit or licence from a government official. You are not free to work overtime at terms mutually agreeable to you and your employer, unless the terms conform to rules and regulations laid down by a government official.

You are not free to set up a bank, go into the taxicab business, or the business of selling electricity, or telephone service, or running a railroad, a busline or airline, without first receiving permission from a government official.

You are not free to raise funds on the capital markets unless you fill out the numerous pages of forms the SEC (Security Exchange Commission) requires and unless you satisfy the SEC that the prospectus you propose to issue presents such a bleak picture of your prospects that no investor in his right mind would invest in your project if he took the prospectus literally. And getting SEC approval may cost upwards of £100,000—which certainly discourages the small firms our government professes to help.

Freedom to own property is another essential part of economic freedom. And we do have widespread property ownership. Well over half of us own the homes we live in. When it comes to machines, factories, and similar means of production, the situation is very different. We refer to ourselves as a free private enterprise society, as a capitalist society. Yet in terms of the ownership of corporate enterprise, we are above 46 percent socialist. Owning 1 per cent of a corporation means that you are entitled to receive 1 percent of its profits and must share 1 percent of its losses up to the full value of your stock. The 1979 federal corporate income tax is 46 percent on all income over £100,000 (reduced from 48 per cent in prior years). The federal government is entitled to 46 cents out of every dollar of profit, and it shares 46 cents out of every dollar of losses (provided there are some earlier profits to offset those losses). The federal government owns 46 percent of every corporation—though not in a form that entitles it to vote directly on corporate affairs.

It would take a book much longer than this one even to list in full the restrictions on our economic freedom, let alone describe them in detail. These examples are intended simply to suggest how pervasive such restrictions have become.

The views expressed in this booklet are not necessarily the views of the Forum of Free Enterprise.

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good."

—**Eugene Black**

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FORUM OF FREE ENTERPRISE

The Forum of Free Enterprise is a non-political and non-partisan organisation, started in 1956, to educate public opinion in India on free enterprise and its close relationship with the democratic way of life. The Forum seeks to stimulate public thinking on vital economic problems of the day through booklets and leaflets, meetings, essay competitions, and other means as befit a democratic society.

Membership is open to all who agree with the Manifesto of the Forum. Write for further particulars (state whether Membership or Student Associateship) to the Secretary, Forum of Free Enterprise, 235, Dr. Dadabhai Naoroji Road, Post Box No. 48-A, Bombay 400 001.

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