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Freedom, The Rule of Law and Market Economy

Concerning a cognitive dissonance

Detmar Doering

Liberales Institut

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FREEDOM, THE RULE OF LAW AND MARKET ECONOMY

CONCERNING A COGNITIVE DISSONANCE

Detmar Doering

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The Author

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He has studied philosophy and history at Cologne University (Ph.D. in Political Philosophy in 1990) and University College London.

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Kräfte des Wandels? (with Lieselotte Stockhausen-Doering)(1990)
Die Wiederkehr der Klugheit: Edmund Burke und das Augustan Age)(1990)
Kleines Lesebuch über den Liberalismus (ed., translated into 18 languages/English translation: Readings in Liberalism, published by the Adam Smith Institute) (1992)
Liberalismus: Ein Versuch über Freiheit (1993)
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Vernunft und Leidenschaft. Ein David-Hume-Brevier (ed., 2003)
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Traktat über Freiheit (2009)

He also published numerous articles in German and international academic journals and daily newspapers on economic, political and historical subjects.
Member of the Mont Pelerin Society since 1996.
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Contents

Freedom is so valuable that we must be prepared to sacrifice everything for it;, even prosperity and opulence when economic freedom constrains us do so. To our great and undeserved fortune however, freedom based economic order which general freedom cannot do without, has an incomparable material superiority over an economic order based on force.

Wilhelm Röpke, 1959

1. Cognitive dissonance or contradiction?

Market economy is often subject to suspicion. It appears to represent an aspect of freedom that not everybody feels secure with. Already in Germany (but not only here) stress on a supposed contradiction between the understanding of the rule of law or civil rights freedoms on the one hand and market freedom on the other hand is becoming more and more pronounced. Party political fault lines and deep chasms in the electoral landscape come and go. More than a few civil rights liberals see market economics as a non-essential part of personal freedom; some market economists in turn believe that civil rights is a luxury of limited relevance. Civil rights are often considered to be a, left' theme whilst market freedom is seen as 'right'. More and more, freedom is divided into ‚good' and ‚bad' freedom. The number of individuals who unreservedly embrace freedom does not seem to be particularly large.

Those who live in countries whose rule of law is non-existent or severely limited will probably see things differently. They will then with some degree of certainty live, in the best case scenario, in a ‚quasi-market economy' run along despotic lines or in the worst case scenario, North Korea where it must be clear that:

- The separation between rule of law and market freedom is to a large degree artificial and is concerned with a cognitive dissonance rather than a real contradiction. The rule of law and free economy depend upon each other. Where one is threatened, the other is not secure.

This forms the main thesis of this paper. Freedom should be seen as something comprehensive from which one cannot, without danger, simply "cherry-pick" the best tasting fruit.

II. Explanation of terms

In order to understand the homogeneity of the rule of law, overall freedom, and economic liberalism, certain terms should first be explained

a) Freedom…

… is the absence of constraint. Nobody should be subjected to the will and coercive power of other individuals. Freedom is therefore not a matter of ‚atomic' individuals but rather pertains to the relationship that individuals have to one another e.g. it concerns the demarcation of individual rights so that freedom does not endanger similar freedoms in others

b) The rule of law…

… is the commitment of the state to explicit laws. This is important for liberals who otherwise associate use of state monopoly power with despotism. Where law is subjected to despotism, individual rights are in danger. For liberals however, rule of law is not just a case of the state being constrained by law (legal security) as law can also be bound up with principles which threaten freedom, but rather relates to the liberal rule of law whose main aim is the protection of individual civil liberties. On the subject of the liberal rule of law, there are the following terms.

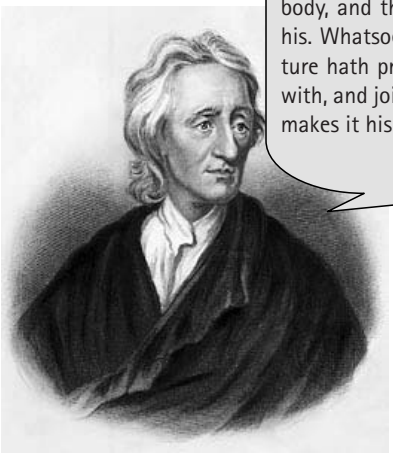
c) Economic freedom…

… is in fact nothing other than the area of freedom that relates to the economic sphere. This also applies to market economics.

Freedom, rule of law and economic freedom are not three different, separate and unconnected things. They are closely interwoven and dependent on each other. Freedom is thus the parentheses which hold everything together.

III. The basic premise: a little philosophy.

Whoever really desires freedom must also desire economic freedom. Freedom means the absence of constraint. Conversely therefore, any action is only truly legitimate when it does not result from constraint and force. This also applies to the economic dealings of individuals as long as they do not injure the person or property of other individuals. We owe this basic premise to John Locke, the English Philosopher: an individual is the owner of him or herself. This should really be self evident today since slavery has been ultimately condemned under international law. This also means however that everything that individuals freely acquire e. g. without constraint, force or threat, is their own property because it could hardly be taken away from them without force. Right to property is legitimised through the principle of first purchase and legitimate labour. It is therefore the task of the rule of law to protect such rights to property. Thus the individual is protected against both despotism and constraint. The framework within which individuals can trade freely is therefore laid out.



„Though the earth, and all inferior creatures, be common to all men, yet every man has a *property* in his own *person*: this no body has any right to but himself. The *labour* of his body, and the *work* of his hands, we may say, are properly his. Whatsoever then he removes out of the state that nature hath provided, and left it in, he hath mixed his *labour* with, and joined to it something that is his own, and thereby makes it his *property*. "

John Locke
(English philosopher), 1689

As Locke in his ‚letter concerning toleration' writes:„Civil interests I call life, liberty, health, and indolency of body; and the possession of outward things, such as money, lands, houses, furniture, and the like. It is the duty of the civil magistrate, by the impartial execution of equal laws, to secure unto all the people in general and to every one of his subjects in particular the just possession of these things belonging to this life."

According to this approach, personal and economic freedoms are ultimately inseparably interwoven.

As well as personal and economic freedom, individuals are stamped by society e. g. a society which defines the sphere of law over individuals. Thus, the principle of free cooperation moves into the centre. Under the rule of law, contract law i. e. freedom of contracts takes on a central role.

The principal of freedom is surely automatically bound up in an economic system. As well as market economy, it also makes free self organisation in the form of cooperatives conceivable. For both, the liberal rule of law can build a framework of freedom in the form of citizens' rights as well as co-operative and societal law.

Thus the aim is defined. The rule of law should protect the rights of individuals in their dealings with each other. It should guarantee them the development and possibilities to trade that they can implement themselves without coercion. It must therefore function very unobtrusively. The rule of law in an economic context is thereby a regulatory policy. It should build a legal framework within which individuals can freely coordinate their economic activities by means of the price mechanism. The non-liberal state however will strengthen process policies which impose or manipulate concrete demands on individuals in the market (such as artificial monopolisation or subsidization of certain products).

IV. Economic freedom: empirical measurement

Whilst we are on the theme of market economics, its core element is economic freedom. In order to measure and assess this economic freedom there is an analytic instrument, namely the annually published index ‚Economic Freedom of the World'. In this index the economic freedom of 141 countries is measured according to the following definition

"The key ingredients of economic freedom are personal choice, voluntary exchange, freedom to compete, and protection of person and property. Institutions and policies are consistent with economic freedom when they provide an infrastructure for voluntary exchange, and protect individuals and their property from aggressors seeking to use violence, coercion, and fraud to seize things that do not belong to them. Legal and monetary arrangements are particularly important: governments promote economic freedom when they provide a legal structure and law-enforcement system that protects the property rights of owners and enforces contracts in an even-handed manner. They also enhance economic freedom when they facilitate access to sound money. In some cases, the government itself may provide a currency of stable value. In other instances, it may simply remove obstacles that retard the use of sound money that is provided by others, including private organizations and other governments. However, economic freedom also requires governments to refrain from many activities. They must refrain from actions that interfere with personal choice, voluntary exchange, and the freedom to enter and compete in labour and product markets. Economic freedom is reduced when taxes, government expenditures, and regulations are substituted for personal choice, voluntary exchange, and market coordination. Restrictions that limit entry into occupations and business activities also retard economic freedom."

Economic Freedom of the World 2003

The idea for this index came in the 80s from Milton Friedman, the Nobel Prize winner for Economics. In 1996 everything was ready. Under the organisational leadership of the Canadian 'Fraser Institute', the first study, ‚Economic Freedom of the World' was published. The publication was initially supported by 12 think-tanks and research institutes. They together agreed on an ‚Economic Freedom Network (EFN) which has in the meantime grown to include 52 similar organisations in 80 nations and territories. In Germany, this is the Liberal Institute of the Friedrich-Naumann-Stiftung for the Economic Freedom Network.

Freedom terminology must be in the position to cover the most comprehensive possible raster of criteria that embrace individual phenomena in the overall context of national economies

1. Size of government: expenditures, taxes and enterprises
2. The legal structure and protection of property rights
3. Access to sound money
4. Freedom to trade internationally
5. Regulation of credit, labor, and business

In each of these areas, various individual indicators are compiled (with regard to the components of the legal system these are Indicators for the protection of intellectual property rights and the independence of the courts) and so arranged that they are given a score of between 0 and 10. Here, 10 is always the ‚best' score meaning maximum freedom. Altogether, each country is assessed using 48 indicators.

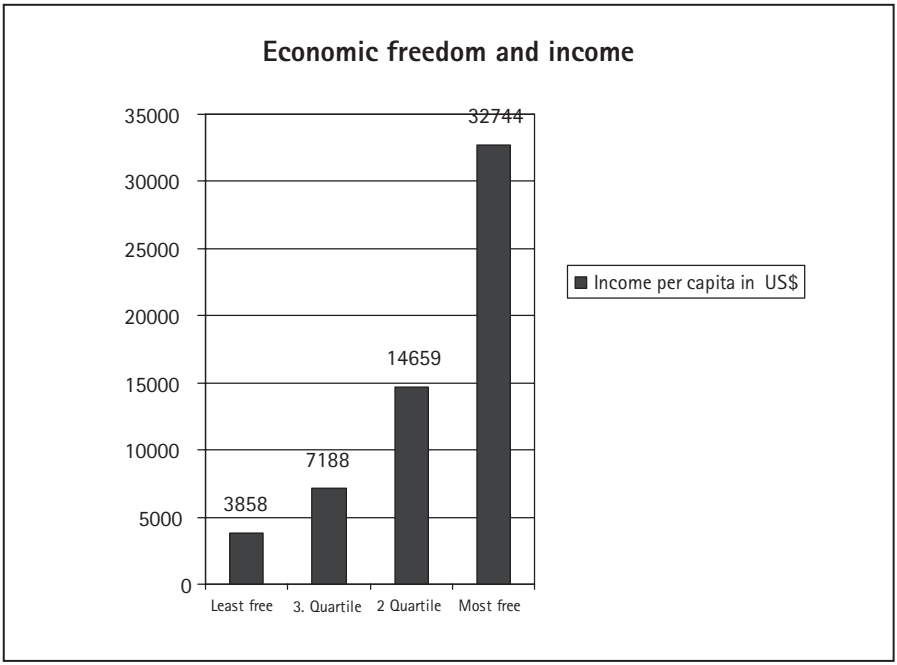
Thereby it is ensured as strictly as possible that the data should be measurable and quantifiable. In individual cases, research is also referred to which – in common with the index of the ‚World Economic Forum' – is based on assessment surveys. This as far as possible was the aim behind 'Economic Freedom of the World'; an aim which, taking individual cases into consideration, leads to the assessment of legal systems.

As regards other empirically verifiable and quantifiable criteria, official and comparable data, particularly from the World Bank, is also taken into consideration.

Where states do not submit this data, countries are not assessed. States such as Cuba, Saudi Arabia or North Korea whose official data is notoriously falsified or unreliable, remain ‚outside'.

If economic freedom is intrinsically valuable, whether or not it produces other benefits, then a measure of economic has intrinsic freedom. However it can also be used to study The measurement of economic freedom only makes sense when it is not an end in itself. Ultimately, research interest is related to evidence of the correlation between freedom and other prosperity factors. In order to conduct this methodology as ‚cleanly' as possible, it is naturally not simply sufficient to correlate the degree of freedom of individual countries with their growth rate, unemployment figures etc. Measurement must take place over a long period (‚Economic Freedom of the World 2010' comprises data since 1980).

Above all there must be a pooling of countries. In individual cases, special individual factors (such as mineral resources) or single events (natural catastrophes) can influence prosperity factors without verifiably affecting the correlation with economic freedom levels. Therefore in the 'Economic Freedom of the World' countries are divided into quartiles e.g. the group of the freest countries, the second freest countries and so on. Only when this correlation is taken in aggregate can general assertions about the correlation be credibly made. The immediate aim of ‚Economic Freedom of the World' is the measurement of the correlation between economic freedom and prosperity. The index has largely established this correlation; for example the correlation between economic freedom and per capita income.



Quelle: Economic Freedom of the World 2010

Here one sees that per capita income in a quarter of the economically freest countries is almost 10 times as high as in the least free. Similar clear correlations can be determined with factors such as growth, life expectancy, education, infant mortality and many more. But what about the correlation between economic freedom and general freedom?

V. Right to property: what the rule of law and market economies have in common.

It is already clear that the economic freedom measured in the 'Economic Freedom of the World' also has a lot to do with ownership as economic freedom most importantly involves the exchange of property rights. The rule of law which denies the right to property in order to materially and totally control or limit individuals has ceased to be a rule of law. There would in this case be no freedom left. There may well be other aspects of the rule of law that are equally important such as institutional aspects (e.g. separation of powers, the independence of courts etc), but without a certain (high!) level of property security they are in-effective. Even immaterial or intellectual rights that should be protected under a liberal rule of law can also mostly be viewed under the category 'property'. Is individual opinion, which is ensured under the right of freedom of expression also not a right of property? Is not every freedom in principle the exclusive power of control of something owing to someone – also ‚property'? Are not certain immaterial/intellectual freedoms such as freedom of the press only conceivable when the right to property exists?

Just as right to property is a prerequisite of the liberal rule of law it is also the core of liberal economic philosophy. Property rights make free exchange, purchase, lending, gifting, investing and other economic relations between citizens possible.

In short: right to property is one of the most important factors of the two basic components which hold a free social order together – the liberal rule of law and market economy!

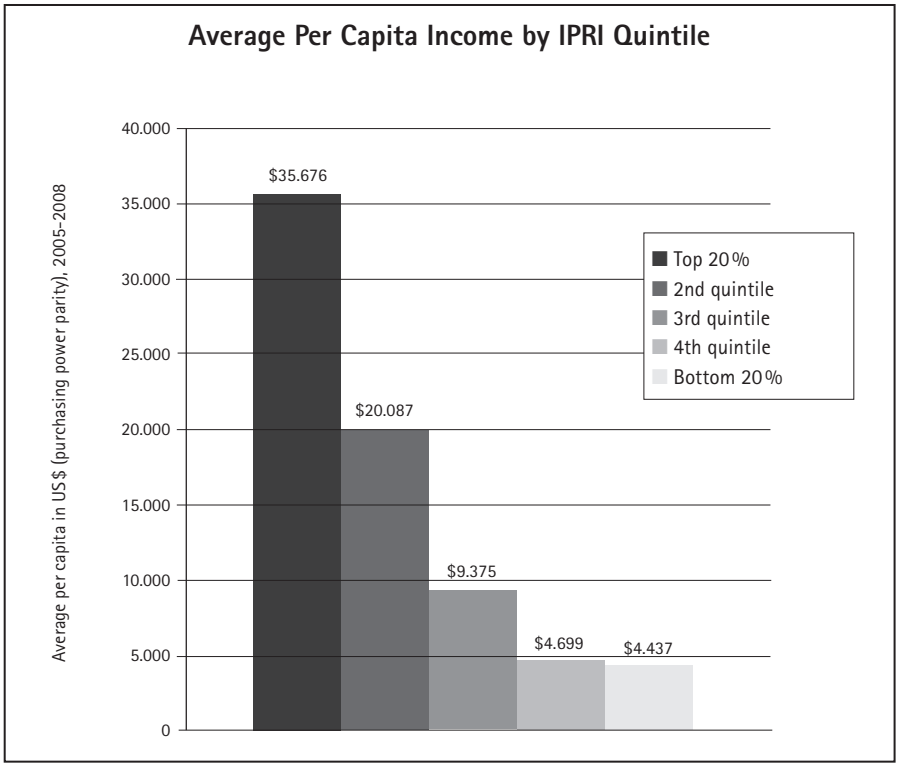
As well as personal protection from violent attack in personal affairs, a right to property allows citizens individual responsibility over the economic aspect of their lives in the form of participation in a market economy which, without such right to property, could not function.

Each individual has knowledge which is uniquely at his/her disposal. Each individual has any number of needs of which only he or she is aware. Everything changes constantly in time and space. His or her dealings and economic activities with others must be coordinated in order to survive. It was a mistaken belief among all planned economists that they thought that such processes could be best dealt with by one or more centralized state bureaucracies. This is in fact how the market functions. Within it, individuals can better utilise their knowledge and resources than via a central authority. Moreover, there is always a certain pressure to perform. In this manner the market works on a 'discovery principle' (Friedrich August von Hayek) for the optimal utililization of labour, capital, and resources. In this respect, a market economy is unbeatable. This is only the case however when individuals can genuinely contribute their labour, their capital and their resources to the process. This again they can only do when they are really in control of them. In this respect, a legally guaranteed right to property is required.

Legally guaranteed right to property is an important source of general prosperity and is also capable of being measured. The yearly 'International Property Rights Index' (IPRI) which is published by an international group of research institutes under the leadership of the American *Property Rights Alliance*, assesses every year the concrete situation of legal property protection (the legal environment of protection for physical and intellectual rights to property) in 115 countries. The results are clear as shown by the following diagram. By way of explanation: countries are separated into quintiles and ranked on a scale from 0 to 10 points .0 denotes no or little protected right to property, 10 denotes optimal protection.

In the quintile of countries with the best ranking for protection of rights to property the gross domestic product is also the highest. Where there is limited protection, poverty is widespread. Unfortunately this is the case with the majority of countries assessed. Where the right to property is not protected and where citizens have therefore no legal property rights, poverty rules.

Meanwhile, these findings have also shown up in developing economies. In his book *'The Mystery of Capital'* published in the year 2000, the Peruvian economist Hernando De Soto established that in developing countries the poor often bring extraordinary economic talents to their working lives although mostly in the black market i.e. the informal economy. The economic potential in illegal slum settlements in large cities could be particularly great. If they could be brought into the legal economy, underused resources could result in increased prosperity. Legal right to property is formally registered, protected from theft



and can above all be used as collateral for bank loans. The latter is pivotal for capital accumulation. As they have no real right to property, the poor only have a plethora of 'dead capital' at their disposal. The total of this 'dead capital' in developing and transitional countries, De Soto maintains, amounts to at least $9.3 billion dollars and is thus much higher than any development aid could be and would be more than sufficient to be re-employed. Thus a solid registration of right to property through authorities and a similarly solid legalisation of informal property rights for the poor must take place. The fact that most individuals in the world have no real right to property at their disposal is the cause of monumental misery.

Naturally, this sounds a little too much like the 'magic bullet' which, as is generally known in economic and social policies, seldom works. Where this approach has been tried, it has never totally produced the desired results. One horrific example was the legalisation of the previous illegal poor quarter in Cambodia's capital, Phnom Penh in the year 2002. Shortly before this legali-

„Totes Kapital"

„By our calculation, the total value of the real-estate held but not legally owned by the poor of the Third World and former communist nations is at least $ 9.3 trillion."

Hernando de Soto
(Peruvian economist), 2000

sation, arsonists and riot squads went to work and drove out the inhabitants, 'accidentally' ensuring that valuable city properties, far from falling to the poor, fell to rich speculators with political connections. But even in cases where such atrocities were not committed, the expected gigantic capital accumulation never materialised.

In reality, utilisation of rights to property requires far more than just formal legal recognition and proper registration. It requires a working small bank sector, a politically and economic legally independent justice system, a non-privileged distribution policy, less corruption and much more. In the end, it is clear that De Soto's economic discovery does not primarily revolve around an economic question. De Soto in fact discovered a loophole in the rule of law! Closing this loophole is no easy task, but it is the only way towards sustainable development. De Soto's formulation is on the right path even though it is stony one.

There can be no question that a citizen's right to free disposal of his or her property is an important prerequisite to general prosperity. However, this prerequisite has in turn another prerequisite; namely a workable legal system that protects this right of property disposal. Only thus can economic freedom produce strong results.

VI. Economic freedom, freedom and human rights

But has what has been measured also something to do with freedom beyond the pure economic sphere? Opponents of liberalism like to claim that economic freedom can also flourish in otherwise objectionable regimes including Singapore or Chile in the time of the Pinochet dictatorship. Sometimes the argument is positively turned: a successful economic transformation can be best accomplished under authoritarian control. The success of China and evidence from Russia in the Yeltsin era demonstrates that anticipated economic political liberalisation can be harmful. One hears this view more and more.

There is one problem here and it is also the basis for attempts to develop a genuine freedom index: a comprehensive freedom index does not exist. However, there are at least individual indices which already allow a certain overview as we shall see from what follows.

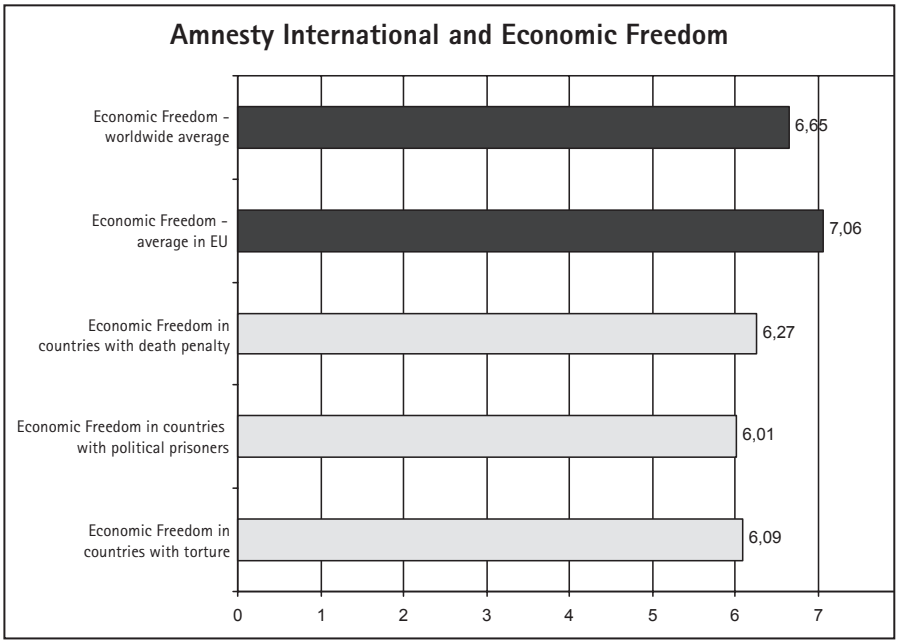
These opponents make the rather improbable assumption that economic freedom can be arbitrarily combined with slavery and other kinds of lawlessness. Whoever so argues, explains all probabilities as exceptions to the rule. The economic existence of mankind is ultimately narrow and to a large degree bound up with total human existence. Consequently an economic, interventionist state almost inevitably infiltrates into the private sphere of every individual. One only has to think of the acquisition of private information necessary to maintain a complex taxation system and the necessities of life covered by the welfare state. This has resulted with little doubt in the immense expansion of state activity in modern welfare states which many believe substantially limits economic freedom by markedly increasing the danger of all pervading intervention in the private sphere. This may, at least in democratic and prosperous states in industrial countries, be more of a potential rather than a real threat, although this cannot be guaranteed. However, real and acute abuse of human rights can be documented.

This affects the rule of law in many different countries. It would therefore be useful to look for a correlation between human rights and economic freedom from which 'social' human rights proclaimed by many states are factored out, thereby successfully focussing on civil rights and liberties. The first foundations have been made by the data in the 2010 yearly reports from *Amnesty International* (AI) on states which make use of torture and those with political prisoners plus a similar document, also published by a AI 'When the State Kills-List of States With and Without the Death Penalty' (February 2009). Countries which implement the death penalty in law and in practice, those in which there are

political prisoners and countries in which torture and excessively gruesome punishment is used are examined in the following graph which details the economic freedom that their citizens are able to enjoy.

A precarious human rights situation, as the graph shows, normally involves less economic freedom. Not withstanding this, a group of countries (yellow) with corresponding ratings from Amnesty International, clearly lie under the already not exactly impressive world average of 6.65 points (from a maximum of 10). Even clearer is the comparison with the average of member countries of the European Union (7.06 points) which as a collection of countries boasts a very high level of constitutional law/rule of law and economic freedom.

To address possible objections: *Amnesty International* does not claim that their reports contain a complete statistical compilation or even an exact rating and ranking. Ultimately, data concerning human rights abuse from AI can only be compiled where at least minimal conditions for compilation exist. Only in those countries where the death penalty is practised and has a firm legal foundation can a complete picture emerge. Furthermore, 'Economic Freedom of the World'

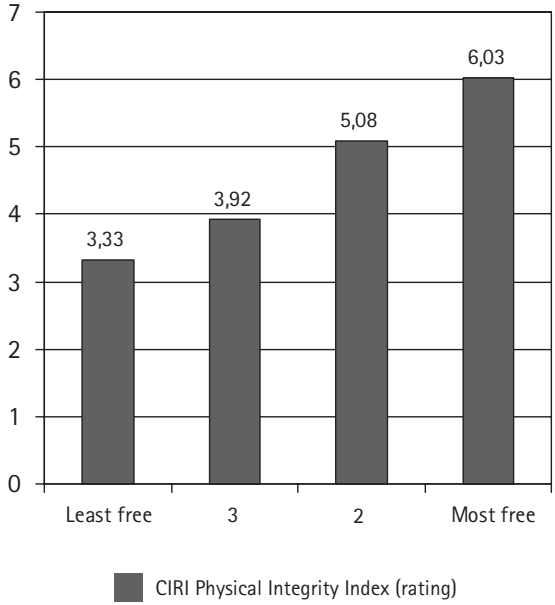


Quelle: Amnesty International Report 2008, AI: Wenn der Staat tötet 2009, Economic Freedom of the World 2008

does not analyse all the countries that AI analyses as some countries either can't or won't supply pertinent economic data. A lack of transparency which as a rule is a clear sign of a lack of rule of law (which must always consist of open verifiability and compliance to rules) means that an array of some of the overtly worst human rights abusers in the international community is not included in this graph whereas states with excellent human rights situations invariably also have a transparent economic policy which is always analysable. North Korea with its 'hunger communism' and the genocidal regime of Omar Bashir in Sudan are for example not represented. That "too much" economic freedom is to be expected from them no one would seriously believe. Thus the political economic picture that is shown here is, in spite of all the gloom, is not distorted in favour of states that support human rights abuse. In short: even if this graph does not satisfy economic 'watertight' conditions as a result of statistical shortcomings in order to fully understand the correlation between human rights and economic freedom, this does not mean that the correlation between human rights abuse and a lack of economic freedom does not exist. The opposite is true. The evidence suggests that a comprehensive compilation (as far as it is possible) would reveal an even deeper and more shocking correlation.

A better insight is supplied by the Cingranelli-Richards Human Rights Dataset (CIRI) from the American Binghampton University. This index contains the various official human rights acknowledged by the international community and – an advantage over the AI report-has a rating scale. The rights are broken up into various categories (fairness in judicial systems, democratic rights etc) which facilitate matters. Here the 'Physical Integrity Index' is of particular interest as it comprises only of human rights abuses that violate against real civil liberties e.g. torture, political prisoners, arrest without legal process or the 'disappearing' of individuals. Ratings are on a scale from 0 (bad human rights conditions) to 8 (good human rights conditions). In the following graph the data from 'Economic Freedom of the World' is correlated with the CIRI datasets on 'physical integrity'.

Economic Freedom and the CIRI-Physical Integrity Index



Here the results are clearer than in the correlation with the Amnesty International report.

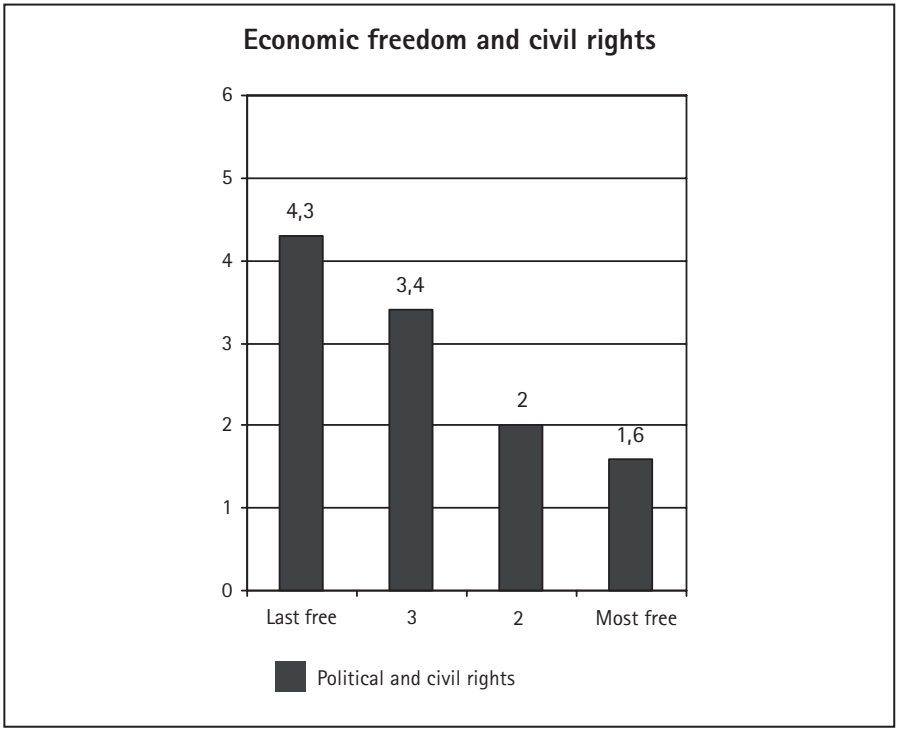
VII. The rule of law and civil rights

To digress. What does this mean in relation to civil rights or constitutional freedom? Here, results from 'Economic Freedom of the World' are correlated with corresponding data.

What follows shows a graph from the 2008 report from 'Economic Freedom of the World'. Here the results of the study are correlated with the civil rights index of the human rights organisation *Freedom House*. One should note that a high score from *Freedom House* denotes a bad human rights balance. The result is clear: conditions are best in the freest quarter of countries. Where the market is overly restricted, freedom is also severely cut back in other areas.

Considered in detail, an even clearer picture emerges. Among the first 20 countries in the *Economic Freedom* Ranking, 16 are classified as 'free' in the Freedom House Index. (New Zealand, Switzerland, USA, Great Britain, Canada, Estonia, Ireland, Australia, Finland, Luxemburg, Iceland, Chile, Denmark, Netherlands, Germany, El Salvador) two countries as 'partly free' (Singapore, Hong Kong, the latter less because of deficiencies in the civil rights sector rather than democratic deficiencies) and only two as 'un-free' (VAR, Oman).

Among the 20 last placed in the 'Economic Freedom of the World', there is only one single country (Argentina) that is classified as free under the democratic rule of law standard applied by *Freedom House*. The rest is shocking: Zimbabwe and Burma to mention only two. The balance would however be even more shocking if countries eliminated by measurement of economic data such as North Korea and Cuba had been included.



Quelle: Freedom House 2009, Economic Freedom of the World 2010

VIII. Authoritarian transformation: is less freedom more freedom?

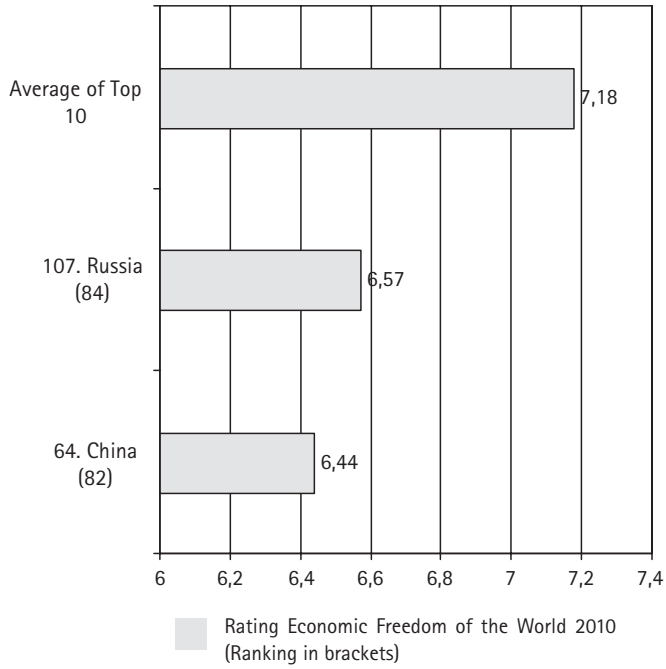
Functional market economies lacking civil rights clearly seem to be the exception! That dictators, who otherwise trample the law underfoot, would not do the same in the economic area (given that this will doubtless be highly profitable for them) is in the end rather improbable from a psychological viewpoint without taking exceptional circumstances into consideration. In Singapore for example, it may be that the small size of the city-state rules out protectionism and autocracy and forces economic openness.

This does not apply to large and powerful China which is often popularly characterised as un-free but also as particularly liberal in economic terms. Especially when compared to Russia under Boris Yeltsin in the 90s when the country went through rapid democratic reform whilst economic reform was derailed, China (along with Pinochet's Chile) would seem to be a possible example of the economic transformation of a previously ailing state or planned economy which functions more successfully under a dictatorial regime. This is, not only from a Liberal perspective, morally questionable and should be empirically scrutinised.

Overall, it is evident that China especially is clearly overrated by the common perception that it is a market economic reform country. Here it is worth taking a look at the ‚Bertelsmann Transformation Index published annually by the *Bertelsmann Stiftung* in Germany. This index consists of two components one of which is concerned with economic transformation and the other-the so-called *'Management Index'*-with the rule of law and democratic transformation. The latter is of interest to us here.

Here one sees that China, a communist single-party state, but also Russia, clearly lag behind. In reality China clearly belongs to the group of less free economies (even though it has made substantial progress since the time of Mao's 'stone age communism'). The 10 most politically effective (i. e. democratic, constitutional) emerging countries including the Czech Republic, Slovenia and Taiwan that are here compared to China, all prove themselves to be freer in the 'Economic Freedom of the World'. Russia does not fare much better. Overall, the best emerging countries politically speaking are also better in terms of liberal economy. Although citizens of some un-free regimes such as China may have more economic freedom than in other personal and political areas, they do not as a rule achieve the level of freedom achieved by systems with the rule of law. Position 82 from 141 does not exactly make China a liberal economic paradise.

China, Russia and the 10 Front-Runners in the Bertelsmann Transformation (Management) Index



Summary: there are of course individual countries were the rule of law is absent but market economic reform is still carried out. These are however, especially in the case of China, over-estimated. The often heard thesis that a non-constitutional autocracy is the best way towards economic transformation and prosperity for poor countries is in its general form, plainly false. As a rule, liberal democracies are clearly more successful than dictatorial regimes when it comes to economic transformation.

IX. Economic freedom as the origin of rule of law?

For the true liberal, freedom is a matter of principle-a priori and universally true. It cannot fall victim to utility considerations as one must be willing to suffer and sacrifice for it. We will not here go into the moral philosophical rationale behind this theory. It should be said however, that despite all great philosophical rationales, freedom as a guiding political principle would never have spread so far or lasted so long if it brought only sorrow and misfortune.

It is therefore more than probable that mankind (at least the large majority of it) has slowly learned the rules that have brought freedom through the process of a developing civilisation because they are ultimately beneficial. In this respect, the liberal rule of law can thank economic incentives for great part of its origin.

What is unusual here is that the learning process must be separated from immediate benefits and advantages. Whoever wishes to immediately realise his or her advantage will not always respect the freedom of others. Economic freedom is-as is every freedom-bound by legal standards that protect it.

„Freedom is so valuable that we must be prepared to sacrifice everything for it;, even prosperity and opulence when economic freedom constrains us do so. To our great and undeserved fortune however, freedom based economic order which general freedom cannot do without ,has an incomparable material superiority over an economic order based on force."

Wilhelm Röpke
(ordo-liberal economist), 1959

We may be inclined to accept certain (dubious) economic model theories based on the idea of the always rational, stimuli-reactive, 'homo-economicus' as an explanation for the effectiveness of market economics. This would seem to confirm the cliché that economic freedom only serves short-term human greed and at best, given the right choice of vehicle, the rational satisfaction of this greed. The reality is that an individual operating in a market is always aware of long-term cooperation interests. 'Homo-economicus' who selfishly reacts to stimuli immediately and in the short term is merely an unrealistic theory constructed by the neo-classical school of economics which ignores the dimension of time. Long-term interests by contrast are definitely real and primarily indicate a stable and long-lasting framework of conditions. This is the reason why individuals save money, agree contracts and build institutions. Extremely stable structures spontaneously emerge again and again in highly individualised market societies. Freedom can only function when it leads to long-term advantage. The well-established thesis that individual freedom and markets destroy the very moral principles on which they are based can thus, at the very least, not be fully accepted.

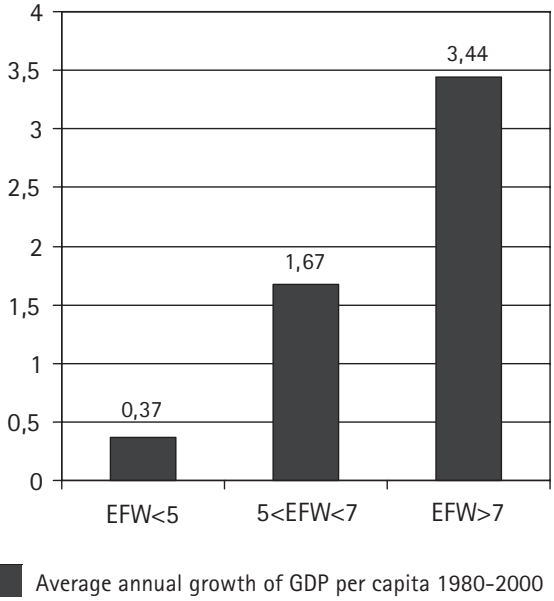
With a degree of exaggeration one can say that beneficial rules/rights are established not as a result of calculations based on individual benefits but rather from the belief that they will pay off better in the long run.

Once again, this only applies when rights are (a) trans-personal and stand above individual interests (b) long-lasting and institutionally stable. For this, the rule of law is required! Only its long-term institutionalisation can produce the desired advantage. Thus non-despotic rule of law/constitutional law is perforce the basis of market economics.

By creating and learning rules/regulations to protect long-term interrelated advantages, order is stabilised and so in turn are the advantages. This explains the strength and attraction of free societies. As a rule, they achieve a peaceful world and a stable framework for their citizens. In every social and economic area, citizens of economically free societies are in a better position than their contemporaries in non-free societies.

The following graph from 'Economic Freedom of the World' shows that success of a market economy can only be guaranteed over the long term whilst political speculation on other factors leads as a rule to short lived (if any) success. This relates to the long-term correlation between freedom and economic growth.

Long term correlation between economic freedom and growth



Quelle: Economic Freedom of the World 2004

Economic freedom is 'sustainable'. There may be un-free countries that attain short-term growth as a result of favourable circumstances (oil wealth for example) but long-lasting prosperity is achieved under stable, constitutional conditions. In the lower third of countries (those with less than 5 points out of 10 on the market freedom scale) growth rate over 20 years is around a tenth of that achieved by the top third (over 7 points).

To put it another way: it is evident that among all the components represented in the 'Economic Freedom of the World' Index, rule of law is the most important in the long-term.

X. Does the rule of law need the state?

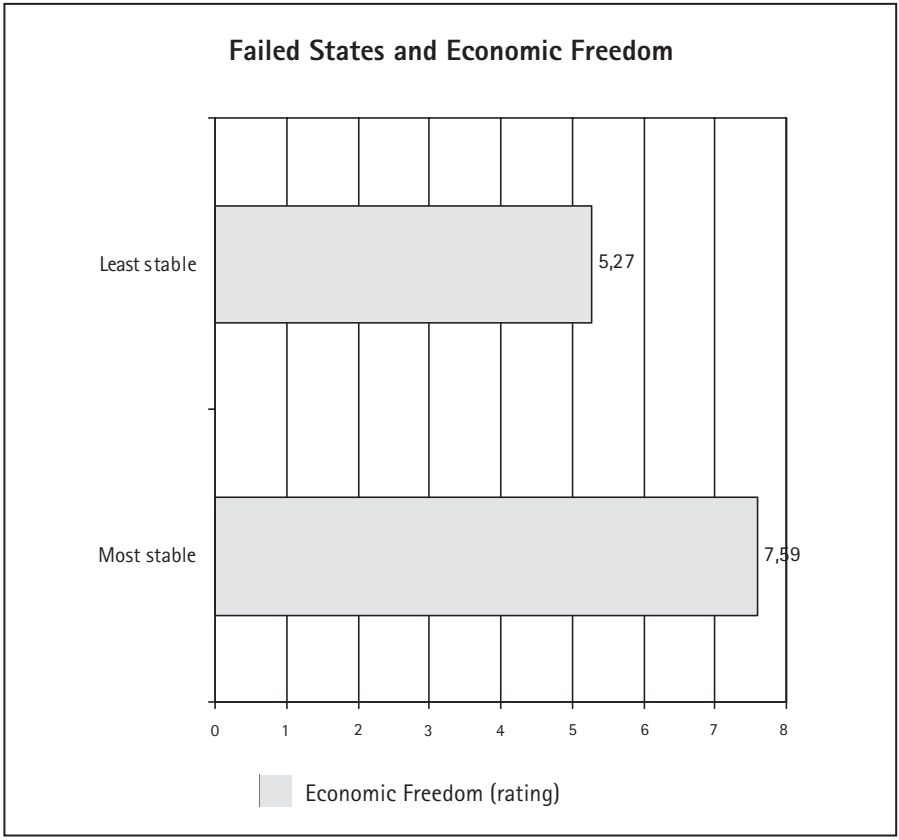
Liberals are seen as 'anti-state'. This reputation is not totally unjustified. Whoever desires freedom is, from a civil rights perspective, in favour of the state not prescribing what to believe religiously, think politically or what lifestyle to lead providing that other individuals are left in peace. And whoever desires freedom is, from an economic perspective, in favour of free economic interaction between individuals e. g. that brings about voluntary agreements without the intervention of third parties (which the state mostly is). This in turn guarantees the ideal of the free market. Thus freedom is something that, in principle, takes precedence over any state constraint.

The state therefore, owing to its very nature, intervenes in the economy and in the private lives of individuals. It can so to speak, do nothing else. In reality, the perfect state that always sticks to the rules, accepts free unseen contracts, doesn't distort the market and guarantees internal and external security in order to protect freedom, does not exist. In theory, this could lead to the assumption that we would do better without the state. In fact there are radical thinkers (often termed 'libertarians') who are seriously considering this. Not all the rules that allow us to live together are set by the state; nor must they be. Monopoly is worse than competition. Could then competition not also better and more efficiently regulate areas that today are left to the monopolistic state-including the law, the police and the army? Here we will allow fine philosophers to speculate. There can be no doubt that total freedom in all regulations and institutions must be a wonderful and desirable dream for every liberal. Whether it functions in reality is another matter that we will not go too deeply into here. One objection should however be raised. The fact that up till now, there has been no actual example of a modern industrial society that can exist without the state (this may be different among primitive, basic societies) poses the practical question of how the state could ever be abolished?

How does one manage to move the state organised society in a peaceful manner to become 'non-state'? Convincing governors and administrators will be difficult. If force is used, it must be stronger than the force it seeks to vanquish. Is one not led to believe that even more state power would be created? It is conceivable of course that the state could dissolve itself so peacefully and harmoniously that the transition to anarchy and total freedom without new power constraints would ensue. Previous revolutions-one thinks particularly of the 'terror' which followed the French Revolution-give little support to these utopian hopes.

In the real world, the state mostly 'disappears' when there is some form of state breakdown. Many factors can lead to this including war, civil war, ethnic tension and demographic developments. The experience of 'failed states' where life as a rule is much worse than in lawfully administered states, is certainly not encouraging.

The following graph relates to the 'Failed State Index' (FSI) which is published annually by the American *Fund for Peace* and based on numerous social, economic and political indicators of degree of failure which measure state breakdown. The state here-for various reasons-is no longer in a position to sustain control of the country.



Quelle: Failed States Index Scores 2010, Economic Freedom of the World 2010

This data is in turn contrasted with compatible data from 'Economic Freedom of the World'. Thus a group of the 38 most unstable countries, defined as 'failed states', is first aggregated including Somalia and Haiti. The same is then done with the group of the 13 most stable countries whose legal system functions flawlessly, including Finland and Switzerland. Results from both groups are then collated with various economic freedom data.

Here one can clearly see that the most unstable or 'failed' states are not market economic freedom zones which can shelter citizens from buffeting by the state.

This demonstrates that the most successful,stable (constitutional) states ultimately concede a major part of economic freedom to their citizens. This is not a perfect solution but obviously the state protected by rule of law allows for a great deal of freedom potential. A failed state does not protect this and as a rule does not apparently replace it with anything better.

XI. Digression: The correlation must be explained!

This much should be clear: rule of law is the basis for economic freedom and economic freedom is a basic component in the rule of law. This does not alter the fact however that a cognitive dissonance exists. The aim of this essay was to demonstrate how groundless this cognitive dissonance is. It involves a double danger, that the rule of law could lose its economic preconditions and that the freedom of market economics could be discredited or deemed as unimportant for the flourishing of liberal order.

Thus it must be clear that a lack of rule of law leads to losses, cronyism and client politics or even to the revitalisation of planned economic policies. This also applies to a traditional under evaluation of certain aspects of constitutional law policy, namely the value of personal freedom. Legitimate interest in legal security is here often so interpreted that the danger which comes from state monitoring and control is underestimated or even disclaimed.

There would however appear to be indications of a reversal in this political trend. Certain issues have awoken concern over the limitations to personal freedom in the economic sphere which was previously not so evident. This has fundamentally changed in the context of the war on terror, an increasing leaning towards the left, and attacks on the privacy of individuals fed by socially populist arguments. An example of the former is the undermining of bank confidentiality (catchword:

terror financing) and an example of the latter are the methods internationally employed using security services in the hunt for tax evaders.

There is also an increasing tendency to burden employers with higher costs, to implement patronising measures designed to 're-educate' people-one thinks of the costs of antidiscrimination legislation (a serious attack on freedom of contract) – or the consequences of the smoking ban for bar owners. The 'nanny state' is at the same time a permanent threat to citizens' personal freedom and the market economic order. Such issues should be pushed much more strongly into the foreground of public debate.

The old rule, 'left' for civil rights and against economic freedom and 'right' for economic freedom and against civil rights seems in many cases not to apply any more. The existence of a correlation between rule of law and economic liberalism must take a constellation of opposition into consideration but there is also a new openness.

Perhaps we are going through a period in which the cognitive dissonance which is today found in many political philosophies that wish to play civil liberties and civil rights against market economics will be resolved more and more.

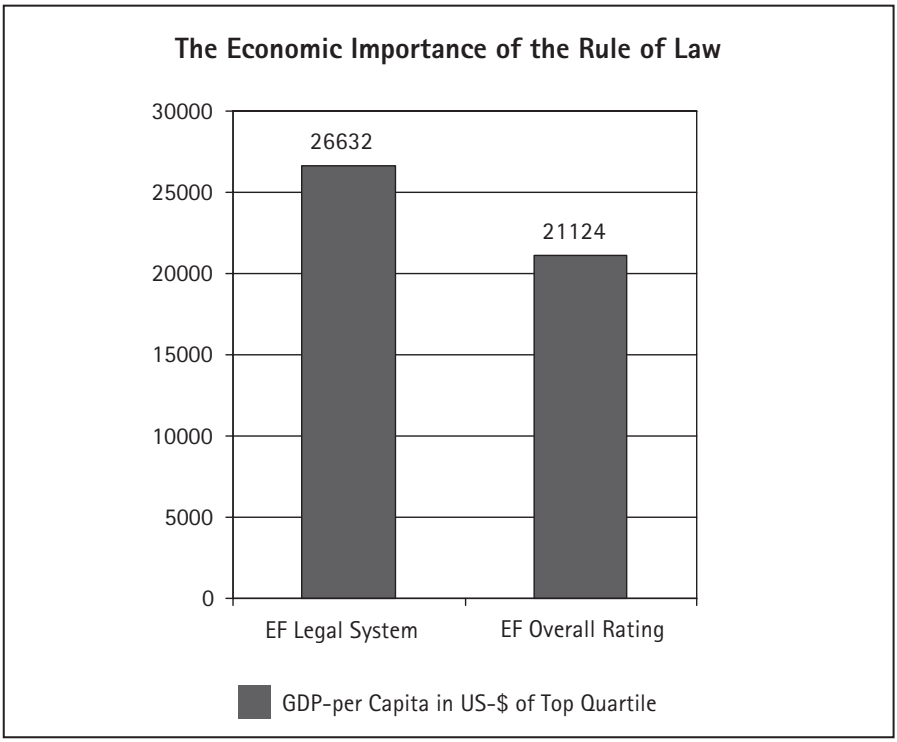
XII. It's worth it!

It has become trendy to see globalisation in the form of worldwide economic liberalisation as the root of all evil. The financial crisis since 2008 - even though it was caused to a large degree by state entities and their policies on 'cheap money' – has increased once again the trend towards market scepticism. However this scepticism goes against all empirical evidence. Where economic freedom exists protected by institutions under the rule of law, individuals fare better than in cases where they do not exist. The worst poverty catastrophes have invariably occurred in dictatorial countries lacking a constitutional state economy.

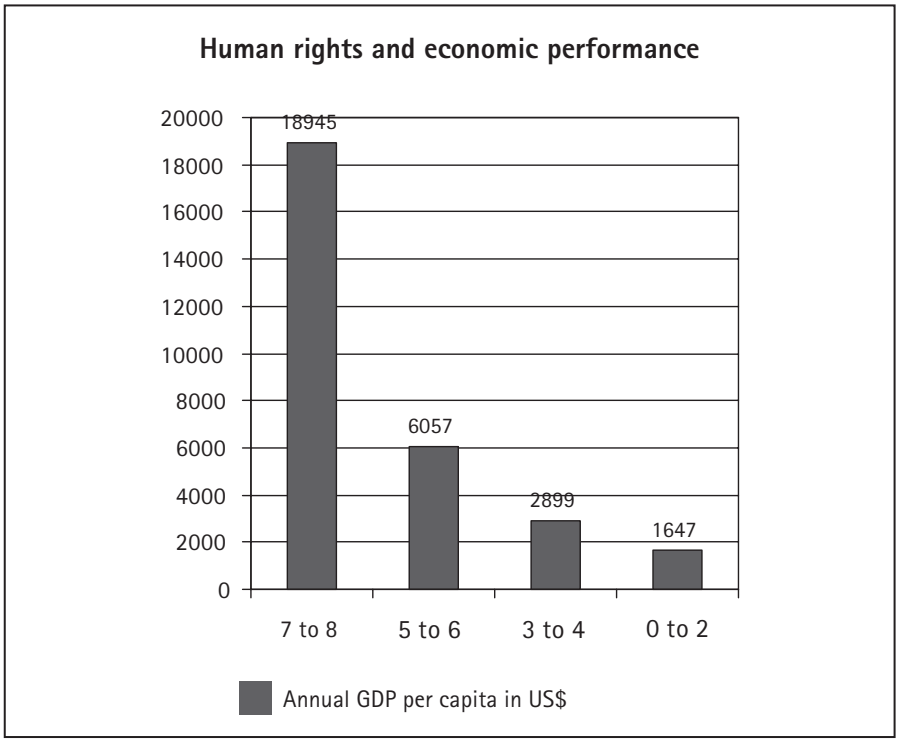
Freedom, human rights and market economies depend on each other. In order to illuminate the correlation in its many facets, one further aspect is missing. That economic freedom mostly goes together with other freedoms has already been shown. The same applies to the correlation between prosperity and economic freedom-the selfsame theme of 'Economic Freedom of the World'. But how important then is the rule of law? How important are civil liberties and

human rights for the functional market which maximises prosperity? Some evidence is already provided by 'Economic Freedom of the World'. Basically the index includes one component, alongside 4 others (state boundaries, currency stability etc) which concerns legal security of the legal system and the protection of rights to property-in other words the rule of law in the economic sphere. How important is this component in the context of economic freedom? This is shown in the following graph.

The graph shows how much GDP per capita is generated by the upper (freest) quartile in the 'Economic Freedom of the World'. On the left is the upper quarter of countries that are only ranked under the 'legal system' component. Clearly the presence of a legal system has a pronounced and above average importance. The rule of law is thus a particularly important requirement for economic freedom as well as for economic success.



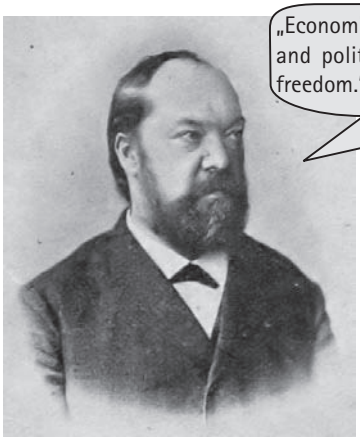
Quelle: Economic Freedom of the World 2010, World Bank 2010



Quelle: Economic Freedom of the World 2010, World Bank 2010

The same applies to human rights and civil liberties which are closely bound up with the rule of law. Once again the CIRI-Dataset on 'physical integrity' (7 to 8 points equals a good human rights situation, 0-2 points equals a bad situation) can be consulted. When correlated with GDP per capita, the findings are clear.

In short: economic freedom is valuable and is not achieved in this world without a liberal rule of law which ensures basic civil liberties. The opposite is also true. The rule of law will not blossom without economic freedom. Thus economic freedom and the rule of law should not be separated. They are not only bound together in theory, but also in practice. The apparent contradiction involves a cognitive dissonance that must be overcome.



Eugen Richter
(Liberal Party Leader), 1896

Of particular relevance is the following quote from Eugen Richter, a leading liberal in the years before World War I who established as early as 1896 that: „Economic freedom is not safe without political freedom and political freedom finds its safety only in economic freedom."

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