

POLICY WATCH

BB&T CENTER FOR ECONOMIC AND COMMUNITY DEVELOPMENT

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MY FORMULA FOR ECONOMIC SUCCESS: Prosperity = Freedom – Corruption

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I came up with a Formula for Economic Success as an answer to the question, "What is there to be thankful about?" The terms in the Formula are defined below using the Merriam-Webster Dictionary online.

Prosperity: "the condition of being successful or thriving, especially economic well-being."

Freedom: "the quality or state of being free: as the absence of necessity, coercion, or constraint in choice or action."

Corruption: "impairment of integrity, virtue, or moral principle."

Replacing the terms of the formula with their definitions, maximum prosperity flows from more freedom and less corruption as follows:

Greater prosperity, a people enjoying more success or more thriving (especially economic well-being), corresponds with a greater quality or state of being free, absent necessity, coercion, or constraint in choice or action and a lesser impairment of integrity, virtue, or moral principle.

Adam Smith in his most recognized two works, *The Theory of Moral Sentiments* (1759) and *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), first laid out the elements of Prosperity, Freedom and personal discipline needed to maximize Prosperity. By Freedom, Smith meant an individual is naturally free to have economic initiative to produce goods and services wanted and needed by other people, to trade goods and services, and to consume goods and services produced by others. He also noted the purpose of production is consumption. Since economic exchange existed from the beginning of humanity's presence

ABOUT *POLICY WATCH*

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on earth, there is no need to establish it by government fiat.

The principles that support these individual Freedoms are property rights, enforceable contracts, and the rule of law. In all such free social exchanges, both the buyer and seller benefit as does the wider community through the creation of Prosperity. The life and career of Steve Jobs is a perfect example of this natural process. Steve Jobs produced electronic devices wanted by other people. The people of Japan need not know anything about Steve Jobs to want an iPod, iPhone, or iPad; and Steve Jobs does not need to know the people of Japan for social exchange to take place. In the process, Steve Jobs created great wealth and prosperity for millions of people he did not know personally. Prosperity for the wider community naturally flows from Freedom with integrity.

Smith's vision based on natural law and natural liberty concepts was finished in time for the American Revolution of 1776 where many of his ideas were put into the Declaration of Independence, the Bill of Rights, and the United States Constitution.

In addition to defining Freedom in these terms, Smith also defined Corruption in his own way. From what he observed, Corruption came in the form of people not respecting property rights, contracts, or laws in the private sector. He also saw Corruption in the Government sector. He identified monopolies granted, subsidies given, union restrictions on labor, crony capitalism, and mercantilism as corrupt Governmental practices. Unfortunately, these forms of 'political capitalism' survive today in the form of \$38 Billion dollars in 'green' subsidies and other government interference in free markets.

However, Smith also pointed out that Government has three proper roles in Freedom-based societies: 1) national defense (protection of citizens from foreign invaders), 2) justice (preventing one citizen from harming another), and 3) public works (bridges and roads). He noted that public works should be limited in number and scope and are best paid for through usage taxes, that is, tolls paid by those who actually use the bridge or road. Unfortunately, Smith also recognized that government can easily become the instrument of corruption by allowing special interests to have unfair advantage over individuals seeking prosperity. Government interference in free markets is a source of corruption that reduces prosperity for everyone in the long run.

Unlike special interests, Smith noted that Individuals seeking their own prosperity had a natural interest in serving others called enlightened self-interest. Smith also said we all have an impartial spectator, known today as the conscience, which judges our actions toward others as being good or bad. When enlightened self-interest and the impartial spectator are not working to keep an individual's prosperity seeking behavior in balance with moral principles, greed and avarice can dominate outcomes. Let's turn again to the Dictionary to define these terms.

According to the Merriam-Webster Online Dictionary:

avarice: excessive or insatiable desire for wealth or gain.

greed: a selfish and excessive desire for more of something (as money) than is needed.

The difficulty in relying on strict computation from definitions such as these is the obvious subjectivity. Need, for example, is very subjective. Without question, some have greater need or preference for some things than others

may have for the same things, even assuming all other measurable factors are the same. However, it is also evident that Freedom in the absence of a moral compass can lead to corruption that reduces prosperity for everyone. When corruption is concentrated in a government the results can be much more disastrous for the citizens governed because the magnitude of the negative consequences of the corruption is much larger than without the assistance of the government. Think of the government as providing leverage. Unfortunately such leverage magnifies the downside as well as the upside. This is why Smith called for limited government interference in the marketplace and greater reliance on individuals and their social interactions to discipline their actions. The impartial spectator, known as the invisible hand, enforces personal discipline, minimizing the exploitation relative to politically-leveraged injustices.

Minimizing corruption maximizes prosperity. The formula implies that moral failure in capitalism is not a debate about corporations or governments alone, but also about the actions of individuals facing choices including whether or not to do the right thing for others rather than solely enriching themselves. The argument against laissez-faire, or no regulation, does not work any better than the argument for mercantilism, or a command and control centrally planned economy, in the pursuit of prosperity for the maximum number of citizens. As F. A. Hayek wrote in *The Constitution of Liberty* (1960), "the argument for liberty is not an argument against organization, which is one of the most powerful tools human reason can employ, but an argument against all exclusive, privileged, monopolistic organization, against the use of coercion to prevent others from doing better." From a policy point of view, heavy regulation as embodied in the 848 page Dodd-Frank Wall Street Reform Act that is estimated to cost the financial industry between \$3-5 billion over the next three years to implement, drastically changes the competitive mix and creates clear winners and losers. A similar statement could be made about the Affordable Care Act with its 906 pages creating winners and losers in the health care industry. In addition to their complexity and reach, both pieces of legislation also set up a variety of new federal agencies that will issue thousands of pages of regulations to be added to the over 75,000 page Federal Register. A system of laws and regulation so complex and unconstrained is neither fair nor just, prevents the guidance of the invisible hand, and does not provide a pathway to prosperity for all citizens.

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