

## **Peter Bauer=s Market-Liberal Vision**

**James A. Dorn**

Cato Institute and Towson University

Bauer has been a consistent and cogent defender of the role of the market economy in bringing about economic development. No one has done more in clarifying the reach of Adam Smith=s thesis regarding the creative contributions of exchange.

CAmartya Sen<sup>1</sup>

### **A pioneer in development economics**

At a time when mainstream development economists were promoting state-led development planning in the aftermath of World War II, Peter (Lord) Bauer stood firm in his conviction that comprehensive central planning, protectionism, and foreign aid were detrimental to economic development. Indeed, he relied on firsthand experience in Malaya, West Africa, and India, and on classical liberal principles, to reach his conclusion that limited government and economic freedom are the prerequisites for increasing individual welfare.

Pieter Tamas Bauer was born in Budapest on November 6, 1915. He earned a law degree at Budapest University and attended Gonville and Caius College at Cambridge University, where he studied economics and later taught. Most of his distinguished academic career was spent as a professor at the London School of Economics. In 1982, he was made a life peer with the appropriate title Lord Bauer of Market Ward. He was a fellow of the British Academy, a member of the Mont Pelerin Society, and the first recipient of the Milton Friedman Prize for Advancing Liberty, a

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<sup>1</sup>Sen (2000: x).

\$500,000 prize awarded every two years by the Cato Institute. The award cited Bauer's tireless and pioneering scholarly contributions to understanding the role of property and free markets in wealth creation, his demonstration of the negative effects on poor nations of government-to-government transfers, and his inspiring vision of a world of free and prosperous people (Blundell 2002: 55). He died on May 2, 2002, at the age of 86.<sup>2</sup>

Central to Bauer's work is the idea that the essence of development is the expansion of individual choices, and the role of the state is to protect life, liberty, and property so that individuals can pursue their own goals and desires. Bauer's view of economic development as a process consistent with, and dependent on, private property and freedom of contract placed him firmly in the tradition of the great classical liberals. His adherence to the principles of free trade and free people reflected his deep respect for the dignity, rationality, and capabilities of poor people around the world.

### **Conflicting views of development**

For many years following World War II, it was generally accepted that comprehensive central planning was necessary to increase economic growth in less-developed countries. It was assumed that poor people could not and would not save for the future, and that government had to organize economic life for the good of the people.

Bauer questioned that dogmatic and condescending approach. His observation of the informal sector in Malaya and West Africa convinced him that poor people could prosper through hard work, thrift, and foresight when government leaves them alone and protects property rights.

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<sup>2</sup>For a fuller discussion of Bauer's life and work, see Dorn (2002), Harris (2002), and Yamey (1987).

*State-led development*

In 1957, Paul A. Baran, a respected economist at Stanford University, wrote, "The establishment of a socialist planned economy is an essential, indeed indispensable, condition for the attainment of economic and social progress in underdeveloped countries" (Baran 1957: 261). That view was widely held among Western development experts who peddled their theories to the World Bank and other multilateral development agencies. As Gunnar Myrdal (1956: 201) noted, "The special advisers to underdeveloped countries who have taken the time and trouble to acquaint themselves with the problem.... all recommend central planning as the first condition of progress."

Bauer questioned that conventional wisdom and warned that central planning is a threat to individual freedom. Comprehensive planning extends the power of the state and limits individual choice. Consequently, all economic decisions become political decisions, and corruption becomes endemic. As Bauer (1976: 84) noted, "By continuing and extending state control over the lives of the population, central planning reinforces the subjection of the individual to authority. Such a development discourages self-reliance, personal provision for the future, sustained curiosity, and an experimental turn of mind."

The goal of development planners was not merely to control the economy but to control people and remake society. Indeed, Bauer (1976: 188) tells us that Myrdal's main thesis was that "personal conduct and social attitudes are to be restructured in the interest, or at least the declared interest, of higher per capita incomes." The poor were not to be trusted with freedom: they were assumed to be indifferent toward the future and unresponsive to market prices. Thus, for their own good, they would have to be treated as pawns in the hands of the enlightened planners. Bauer found that anti-market mentality disturbing. He did not see the poor as "lifeless bricks, to be moved about by some master builder" (Bauer 1984: 5).

The view of most development experts in the early postwar era was that there is a "vicious circle of poverty" from which the poor cannot escape except with the help of central planners and

external aid. Compulsory saving, protectionist trade policies, marketing boards, state-directed production and investment, and government-to-government transfers were the norm. Bauer (2000: 6) argued otherwise: AIf the notion of the vicious circle of poverty were valid, mankind would still be living in the Old Stone Age.@

He was among the first to see that the real plight of underdeveloped countries is not market failure but government failureCthat is, the failure of government to protect property rights, enforce contracts, and leave markets alone:

The literature of market failure has been used largely as a collection of sticks with which to beat the market system. The critics who propose replacing the market system by political decisions rarely address themselves to such crucial matters as the concentration of economic power in political hands, the implications of restriction of choice, the objectives of politicians and administrators, and the quality and extent of knowledge in a society and of its methods of transmission [Bauer 1984: 30].

The politicization of economic life, the loss of freedom, and the damage done to civil society under comprehensive economic planning are now well known. Even the World Bank, in its 1997 *World Development Report* (pp. 1B2), admitted that the notion that A good advisers and technical experts would formulate good policies, which good governments would then implement for the good of society,@ was naive. AGovernments embarked on fanciful schemes. Private investors, lacking confidence in public policies or in the steadfastness of leaders, held back. Powerful rulers acted arbitrarily. Corruption became endemic. Development faltered, and poverty endured.@

*Bauer=s market-liberal vision*

After studying a number of less developed countries (LDCs), Bauer (2000: 29) concluded that economic development depends on

institutions, culture, and conduct, not on planning, large-scale state investment, or natural resources:

Economic performance depends on personal, cultural, and political factors, on people's aptitudes, motivations, and social and political institutions. Where these are favorable, capital will be generated locally or attracted from abroad, and if land is scarce, food will be obtained by intensive farming or by exporting other goods.

The importance Bauer attached to institutions—especially to limited government and private property—was fully consistent with classical liberalism. He also recognized that population density and growth are not detrimental to economic progress, if the institutional setting is favorable to freedom and responsibility. Indeed, for Bauer (2000: 30), "Economic achievement and progress depend on people's conduct, not on their numbers."

Bauer was especially critical of the argument, widely accepted by development experts, that large-scale government investment is necessary to alleviate poverty. According to Bauer (1957: 119),

It is misleading to think of investment as the only or the principal determinant of development. Other factors and influences, such as institutional and political forces, the qualities and attitudes of the population, and the supply of complementary resources, are often equally important or even more important. . . . It is more meaningful to say that capital is created in the process of development, rather than that development is a function of capital.

The so-called investment fetish of development experts resulted in numerous large-scale projects that were monuments for the ruling elite but did little or nothing to reduce poverty (Bauer 1981: chap. 14).

To think that the poor are incapable of saving and investing for the future is to ignore the lessons of history, argued Bauer. Smallholders (small-scale growers) in Malaya and West Africa clearly had the foresight and the incentive to forgo current consumption in order to plant crops (rubber trees in Malaya and cocoa trees in British West Africa) that required several years before they were ready to be harvested for sale on the market (Bauer 1948a, 1948b, 1954). No coercion was necessary. What was necessary to support small-scale trading activities, however, was that government not restrict entry (Bauer 2000: 9).

In sum, emergence from poverty . . . does not require large-scale capital formation. It requires changes in attitudes and mores adverse to material improvement, readiness to produce for the market instead of for subsistence, and the pursuit of appropriate government policies (Bauer 1981: 248).<sup>3</sup>

*The end and criterion of development*

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<sup>3</sup>Deepak Lal (1985: 103) has argued that the most serious ... distortions in many developing economies are not those flowing from the inevitable imperfections of a market economy but the policy-induced, and thus far from inevitable, distortions created by irrational *dirigisme*.

The unifying element in Bauer's vision of the development process was his emphasis on individual freedom. In *Economic Analysis and Policy in Underdeveloped Countries*, Bauer (1957: 113) wrote: "I regard the extension of the range of choice, that is, an increase in the range of effective alternatives open to people, as the principal objective and criterion of economic development." He did not divorce economic and personal freedom. Rather, he argued, "A market order is a necessary condition of personal freedom" (Bauer 1984: 27). The legal framework was important to Bauer because it helped define the choice set open to individuals.

Like classical liberals, he held that if government is limited to the protection of persons and property, the scope of market exchange naturally increases and individuals have greater alternatives than under central planning. The distinguishing characteristic of the market order, according to Bauer (1984: 25), is that it "minimizes the power of individuals and groups forcibly to restrict the choices of other people." Indeed, in a free market system people normally become rich only by widening the range of choices open to consumers. In contrast, under central planning, little attention is paid to satisfying consumers' preferences.

#### *Law and liberty*

The great French liberal Frederic Bastiat expressed the central idea of freedom under the law when he wrote, "Law is the organization of the natural right to legitimate self-defense; it is the substitution of collective force for individual forces, to act in the sphere in which they have the right to act, to do what they have the right to do: to guarantee security of person, liberty, and property rights, to cause *justice* to reign over all" (Bastiat [1850] 1964: 53). Limited government is therefore an essential condition for economic development in the sense of expanding individual choices.

Building an institutional infrastructure was more important to Bauer than building roads. He did not see fixed capital investment or the physical infrastructure as a precondition for development. Rather, he found that once the property rights structure was conducive to market exchange, the complementary physical

infrastructure would develop naturally. As he wrote in *The Development Frontier* :

A developed infrastructure was not a precondition for the emergence of the major cash crops of Southeast Asia and West Africa. As has often been the case elsewhere, the facilities known as infrastructure were developed as the economy expanded.... What happened was in very large measure the result of the individual voluntary responses of millions of people to emerging or expanding opportunities created largely by external contacts and brought to their notice in a variety of ways, primarily through the operation of the market. *These developments were made possible by firm but limited government*, without large expenditures of public funds and without the receipt of large external subventions (Bauer 1991: 190B91; emphasis added).

If people are to be free to choose, their property rights must be protected by law. Bauer placed a great deal of emphasis on the primacy of property in a market-liberal order and in the development process. The movement from subsistence to exchange requires a legal system that provides secure property titles, enforces contracts, and adjudicates disputes fairly and efficiently. It was clear to Bauer that restrictions on private ownership erode not only economic freedom but also personal freedom.

In his study of the Malayan rubber industry in 1948, Bauer criticized the restrictive practices of the colonial government that prevented smallholders from acquiring additional land. He saw the refusal to alienate land for rubber planting as particularly harmful to the smallholder and socially disruptive:

Rubber production is an industry where apart from statutory restriction, the small man was until recently in a position to start on his own and to secure a decent and independent income, with the possibility

of rising to higher levels; until the ban on new planting and on the alienation of land for rubber planting, estate labourers often rose to the position of medium or smallholders through the development of a rubber holding.... The present policy of supporting production based on large alien labour forces and of preventing the extension of individual ownership of land is directly fostering the growth of extremist political movements (Bauer 1948a: 87).

At a time when most development experts were calling for anti-market, state-led development policies, Bauer was certainly ahead of his time in seeing the importance of economic freedom—especially private property rights—as a key determinant of economic development as well as personal liberty.

### **Free trade and development**

One of the key features of Bauer's approach to development was his insistence on the pivotal role of both domestic and foreign trade in expanding individual choices. A rising merchant class confers benefits on society by providing new alternatives, extending credit, and linking the domestic economy to the international economy. Protectionism restricts choices and denies people the opportunity to specialize according to their comparative advantage and to learn from contact with traders.

Denying individuals the right to trade is not only a violation of their human rights it also makes markets less efficient and impedes the flow of information essential for progress. As Bauer (2000: 7) noted,

In the absence of opportunities for exchange, there is little scope for the division of labor and the emergence of different crafts or skills. The lack of commercial links with a wider society obstructs or precludes the inflow or emergence of new ideas, methods, crops, and wants. Indeed, unquestioning

acceptance of prevailing conditions and the sway of habit and custom are familiar in such economies.

It is no accident, wrote Bauer (2000: 5), that throughout the Third World the most advanced regions are those with [the] most Western commercial contacts; and, conversely, the most backward and poorest are those with few such contacts. One need only examine the performance of North versus South Korea, or to see the progress China has made since it opened to the outside world in 1978, to understand the significance of Bauer's logic.

### **The perpetuation of poverty**

From both theory and observation, Bauer concluded that central planning, protectionism, and foreign aid would perpetuate rather than alleviate poverty. The politicization of economic life sets in once private property and free trade are restricted. Corrupt governments then have an incentive to rely on official development assistance that enhances their power.

Those who argue that LDCs cannot grow without outside help and that poverty is self-perpetuating neglect the fact that to have money is the result of economic achievement, not its precondition. That this is so is plain from the very existence of developed countries, all of which originally must have been underdeveloped and yet progressed without external donations (Bauer 2000: 6).

Foreign aid has often been used to enhance the wealth of Third World rulers and to support their political ambitions rather than to promote the long-run economic health and independence of individuals in the LDCs. Such aid has also benefitted domestic producers in the donor countries. For those and related reasons, Bauer (1984: 40) argued that without foreign aid there would be no Third World: The concept of the Third World and the policy of official aid are inseparable. The one would not exist without the other.... Thus, the Third World is a political and not an economic concept.

Bauer viewed government-to-government transfers, i.e., official development assistance, as an independent source of

hostility to the market. Third World leaders have an incentive to use external aid to gain greater control of economic life: Since the aid is given to governments, it strengthens the position of and enlarges the state sector as compared to the private sector. Moreover, Bauer argued that foreign aid provokes and exacerbates political tension, which again arouses hostility to the market, especially in multiracial societies. Hence, for Bauer, official aid is, in practice, an important antimarket force (Bauer 1978: 182-83).

### **Toward a system of natural liberty**

In 1776, Adam Smith described a system of natural liberty that would emerge spontaneously provided government was limited to several core functions, especially protecting persons and property to prevent injustice. According to Smith ([1776] 1937: 651), when all systems either of preference or of restraint are abolished, the obvious and simple system of natural liberty establishes itself of its own accord. In such a system, every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring forth his industry and capital into competition with those of any other man, or order of men.

Smith's message was extended by Bastiat ([1850] 1964: 94), who wrote, It is under the law of justice, under the rule of right, under the influence of liberty, security, stability, and responsibility, that every man will attain to the full worth and dignity of his being, and that mankind will achieve . . . the progress to which it is destined.

Peter Bauer's market-liberal vision of development is clearly in the tradition of Smith and Bastiat. When government overextends itself and intervenes with the institutions needed for a market-liberal order, freedom will give way to power and development, in Bauer's sense, will cease.

Although significant progress has been made in countries like China that have moved closer to free-market institutions, much work remains to be done to combat the anti-market mentality that Bauer observed and criticized. There is also the danger that illiberal

democratic regimes will undermine support for market liberalism.<sup>4</sup> The challenge for the 21st century will be to move closer to Smith's system of natural liberty by shrinking the size of government and expanding economic and personal freedom. That is why Peter Bauer's market-liberal vision of development is still so important.

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<sup>4</sup>Fareed Zakaria (1997: 42-43) argues that democracy without constitutional liberalism is not simply inadequate, but dangerous, bringing with it the erosion of liberty, the abuse of power, ethnic divisions, and even war.

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