For release on delivery
8 p.m., Eastern Daylight Time
Thursday, June 25, 1970

The Economic Contest Between Freedom and Authoritarianism

Address by Arthur F. Burns,
Chairman, Board of Governors of the Federal Reserve System

Chungang University

Seoul, Korea

June 26, 1970

The Economic Contest Between Freedom and Authoritarianism

Dr. Yim, distinguished guests, and ladies and gentlemen. I am deeply moved by the honor that Chungang University has seen fit to bestow upon me today. I am also happy to have the opportunity to visit the Republic of Korea at this moment in history. It is just twenty years since the armies to the north swept across the 38th parallel in their effort to bring all the people of Korea under the yoke of tyranny.

Because of the valor of your own people and the support of the United States and the other countries that rallied to the aid of the Republic of Korea, you conquered adversity and succeeded in preserving the right to live in dignity as free men and women.

As we think back to those days of struggle, we can give thanks that there were men of indomitable will and courage who recognized the vital importance to Asia and the civilized world of the preservation of freedom for 20 million Koreans.

There were, to be sure, those in the West who described the desperate struggle for the survival of the free Republic of Korea as a quarrel in which other nations had no right to intervene. There were those who said that the Republic of Korea was not really a democratic country and that it made little difference whether it was ruled by Syngman Rhee or Kim Il Sung. There were even those who told us that poor people cared nothing about abstract concepts such as freedom and democracy, that the Koreans were mainly interested in material well-being, and that they could achieve this more quickly under communism than under the free market economy that prevailed in the Republic of Korea.

At the same time, Mr. Khrushchev began to make the point that a similar contest was underway between the United States and the U.S.S.R. He boasted that the Soviet system was vastly superior and that the Soviet Union would surpass the United States in production per capita and in the standard of living by 1970. It may be worth recalling Khrushchev's words:

> "The superiority of the U.S.S.R. in the speed of growth of production will create a real basis for insuring that within a period of, say, five years following 1965, the level of U.S. production per capita should be equalled and overtaken. Thus by that time, perhaps even sooner, the U.S.S.R. will have captured first place in the world both in absolute volume of production and per capita production, which will insure the world's highest standard of living."

Such claims were taken seriously by many people in the West and in the East. Some came to doubt that the free market system was the most efficient and equitable instrumentality for increasing the national wealth. They took the view that freedom was a luxury that poor nations could ill afford. They argued that the underdeveloped countries had to resort to authoritarian control of economic activity, if not also to outright governmental ownership of the productive resources in the economy. And, in fact, a number of countries in Asia did adopt in varying degrees the policy of turning over to the government the decision-making functions that are performed by private citizens in countries that practice free enterprise.

Those who adopted this approach overlooked the fact that Adam Smith, the father of the idea that freedom was more conducive to economic growth than governmental control, had addressed himself to the problems of a nation that was then very poor and very underdeveloped -- that is, to the England of 1776. Two hundred years ago, English peasants, living at a subsistence level without any of the benefits of modern industry or science to ameliorate their condition, were probably worse off than their counterparts in most of free Asia today. And the French peasants lived in even greater poverty than the English.

Adam Smith examined the results of governmental intervention into economic activity in 18th century England and France with a perceptive eye. He came to the conclusion that the inefficient use of resources that he observed could be remedied and that wealth could be augmented if individuals had greater freedom to manage their economic affairs as they saw fit, instead of being tied down by minute and exacting regulations prescribed by bureaucrats. Smith saw that detailed economic regulations, often laid down by authorities far removed from the actual operations or needs of industry and commerce, produced undesirable results even though they may have been or actually were well-intentioned. In time, as the force of Smith's logic and evidence won adherents among men of authority, his revolutionary ideas proved instrumental in sweeping away much of the regulatory complex that had retarded economic progress and in paving the way for the extraordinary increase in living standards that has occurred in the West during the past two centuries.

It has been said that those who will not learn from the errors of the past are doomed to repeat them. This has been the fate of much of Asia in the period following World War II. Fortunately, the Republic of Korea escaped falling under the control of the Marxists and chose to enter the economic contest on the side of freedom.

In addition to being the twentieth anniversary of the invasion of the Republic of Korea, 1970 was also to be the year when the U.S.S.R. would overtake the United States economically, according to Khrushchev's boast. It is fitting, therefore, that we look back over recent years and examine the results of that contest between economic freedom and authoritarianism.

The Contest Between the United States and the Soviet Union

The economic contest between the U.S.S.R. and the United States enters the year 1970 with the United States holding a commanding lead. In 1969 the gross national product per person in our country was nearly $4,600. This was two-and-a-half times the corresponding Soviet figure. Measured in real terms, the gap between the per capita GNP of the United States and the Soviet Union was more than 25 per cent higher in 1969 than in 1960. While the Soviet growth rate was slightly higher than the American rate, the difference was so slight that if the same growth rates were maintained over the next 50 years, the per capita GNP of the United States would still be about twice that of the Soviet Union in the year 2020.

The persisting wide difference between the living standards of the Soviet Union and the United States is vividly portrayed by comparisons of the cost of goods and services and average wages in the two countries. If the prices of goods and services are expressed in terms of the number of working hours required to earn enough to buy them, the difference in living standards appears to be even larger than the crude comparison of per capita GNP figures suggests.

It turns out, for example, that the average worker in Moscow in April 1969 had to work nearly seven times as long as his counterpart in New York to earn enough to buy an identical supply of food sufficient to feed a family of four for one week. The difference for many non-food items was even larger. The following are the multiples by which the cost of certain goods in Moscow exceeded the cost in New York, when cost is measured in terms of working time: for bath soap - 12.5 times, for nylon stockings - 14 times, for a man's shirt - 12 times, for a refrigerator - 12 times.

These comparisons are based on official prices in Moscow, not black market prices, which are, in many cases, far higher. For example, a Volga sedan costing the equivalent of $7,700 reportedly sells for 2.5 times that amount on the Moscow black market.

The inability of the Soviet Union to approach the economic performance of the United States has not been as widely publicized as the dramatic earlier forecasts by the Soviet leaders. Nevertheless, this failure provides valuable economic lessons. The rather high rates of economic growth that were recorded for the Soviet Union in the early postwar years have not been sustained because of deficiencies inherent in the Soviet system, as their own economists have begun to realize. In a free economy, the relative strength of the demand for goods and services determines the allocation of productive resources. In the Soviet system, on the other hand, the path that production takes is basically determined by the decisions of economic planners in Moscow.

Important economic decisions in the Soviet Union have therefore not been guided by sensitive economic signals such as are constantly being transmitted by costs and prices in a free market economy. To make matters worse, until recently, they were not even subject to correction by public criticism. Thus, economic success in the Soviet system came to be measured, traditionally, in terms of meeting targets set by the government, rather than in meeting the wants of consumers. This sometimes led to production of equipment that failed to work or to the output of some consumer goods far in excess of demand while other goods continued to be in critically short supply. Such production might be expressed in a high rate of growth of GNP, but it did not bring progress in the elevation of living standards. In time the waste involved in this process became a matter of grave concern to Soviet officials, particularly to economists and engineers.

As early as 1959, a Soviet econometrician, L. V. Kantorovich, pointed out that it might be advantageous if prices were allowed to play a bigger role in guiding the allocation of resources in the Soviet economy. Another Soviet economist, Professor Y. Liberman proposed that profitability rather than achievement of planned targets be used as the measure of success or failure of productive enterprise.

Although the Soviet Union has tried some experiments with reforms along these lines, there has been no correction of the fundamental flaws of the communist economic system either in the Soviet Union or in its satellite countries. In Czechoslovakia the frustration with the results of centralized decision-making, which reached a climax during the industrial recession of the sixties, was an important factor in the reform movement in 1967-68, but the courageous effort to rationalize the economy by giving greater play to individual decision-making was brought to an abrupt end by Soviet troops and tanks in the summer of 1968.

This result was no great surprise to those who recognized that the reforms required to rationalize the Soviet-style economic system would weaken, if not totally destroy, the political control wielded by the Communist party. Two observers of the Eastern European scene pointed this out a year and a half before the Czech liberalization movement was crushed. They said:

> "Some variations of a limited free-price system are being introduced requiring enterprises to pay some attention to what the market, i.e., the consumer, wants. But there is small sign that the central planners are ready to make these valid by yielding or reducing their arbitrary rule over production costs and profit. They cling to their power to fix prices of raw materials, semi-finished products, fuel and power, the size of total payroll and individual wages, the wholesale and retail prices of finished goods . . . . Surrender of production and investment controls deprives the party faithful of jobs and strips the party of influence . . . . Confronted by such a menace, the Red regimes are marking time with half-measures . . . ."

Faced with a choice between introducing economic rationality and the maintenance of their political power, the Russian rulers chose power. Unless and until they are willing to change their approach, it seems likely that their own economy and that of their satellites will continue to lag far behind the United States and other advanced countries of the free world.

The Failure of Communist China's Great Leap Forward

Even before it appeared that the Soviet Union was not going to be successful in challenging the economic pre-eminence of the United States in the 1960's, it became clear that Communist China was not going to demonstrate to the free countries of Asia a better way to augment their wealth and income.

The year 1958 was hailed as Communist China's "great leap forward." It was claimed that food output had been doubled in a single year, and that final victory had been achieved over hunger. These claims were soon exposed as wild exaggerations, as it became evident in 1959 and 1960 that serious food shortages had begun to reappear. Far from developing self-sufficiency in food and eliminating hunger, Communist China experienced critical food shortages in the early 1960's and was compelled to import huge quantities of grain from abroad to meet her requirements. The agricultural communes which had been so widely acclaimed as the realization of true communism were quietly abandoned or radically modified. Agriculture in China appears to have remained virtually stagnant throughout the 1960's. Although production figures have been withheld, the available evidence suggests that output may not even have kept pace with the increase in population. In the early 1960's, the food shortages were attributed by government officials to bad weather, but this excuse was soon dropped as food imports continued to be required year after year.

The failures of agriculture had serious effects throughout the Communist Chinese economy. It soon became necessary to retrench drastically the plans for industry and transportation. Resources were simply not available to push forward the grandiose schemes that were supposed to show the rest of Asia how a country could rise from agricultural poverty to industrial affluence by purusing the Communist path. Official statistics on economic performance of Communist China became very scarce as the boasted "great leap forward" failed to materialize. Talk of competition between Communist China and free Asia dropped to a whisper once it became evident that the free countries were well ahead in the contest.

Economic Success in Free Asia

The countries of Asia that have relied basically on the free market system and have avoided centralization of economic decisions in the hands of the government have clearly been winning the economic contest. They are the countries that have been most successful in increasing the wealth of their people and in raising their standard of living. The countries that have done the least well have tended to be the ones that either rejected the free market or severely limited it by governmental controls.

North Korea, to be sure, has been claiming a high growth rate, as have other Communist countries in the earlier stages of their development. There is, however, good reason to believe that North Korea suffers from the same serious difficulty that the other Communist economies have encountered -- namely, a tendency to sacrifice quality and serviceability in order to achieve quantitative production targets. Also, as one of the top North Korean leaders recently noted, there are serious deficiencies in the supply of consumer goods. Here is what he said: "The problem is that leading cadres are irresponsible and unconcerned about the working peoples' problems of food, clothing, and housing."

The great economic success stories of Asia in the 1960's are found in countries like the Republic of Korea, Japan, Nationalist China, Thailand, Hong Kong, and Malaysia. These countries, in the 10 years ending in 1968, have all recorded average increases in real output of 6 per cent a year or more. Hong Kong and Japan led the way with average annual growth rates of 10 per cent or higher in this period. South Korea had a very respectable average rate of growth of 7.5 per cent for the entire decade; but for the last five years, after important economic reforms were implemented, Korea's average rate has also been in excess of 10 per cent a year.

Rates of growth of GNP can be misleading, especially in countries where the underlying statistical data are inadequate and of doubtful validity. There are also problems with the proper valuation of output in different countries. The over-valuation of goods of dubious serviceability undoubtedly tends to exaggerate the value of output in the Communist countries. For example, the inferior iron that was produced in the famous backyard blast furnaces of Communist China back in the late 1950's was included in the output totals even though it served no useful purpose.

It is therefore desirable to check the growth figures of GNP against other records. One useful indicator of underlying growth is the trend of exports, since it measures the ability to compete abroad and thus tests a country's efficiency in keeping up with the standards being set elsewhere.

Professor Ota Sik, the architect of the short-lived economic reform in Czechoslovakia, called attention to the fact that Communist economies have great difficulty in meeting the test of economic efficiency posed by exports. As he put it: "On the foreign markets, Czechoslovak production is absolutely unable to adjust to changes in demand." This difficulty has in practice been compounded by production of shoddy quality, poor pricing, and ineffective marketing.

Applying the export test, we find that the countries in Asia that had high rates of overall economic growth in the 1958-68 period, also did very well in expanding their exports. The Republic of Korea recorded a phenomenal increase in exports, averaging 40 per cent a year over the decade. Next came Nationalist China, with an annual rate of export growth of nearly 19 per cent, followed by Japan with a rate of over 16 per cent and Hong Kong with 13 per cent.

There are fascinating stories behind these statistics. The amazing record of Korea in expanding exports from almost nothing a decade ago to over $600 million last year is a modern miracle. I am also impressed by the fact that tiny Hong Kong, with a population of only 4 million, exported about as much in 1969 as all of India.

The export experience of South Korea illustrates how difficult it is for any economist, no matter how farsighted he may be, to chart the future course of a nation's development. In 1969, two of the largest export earners of the Republic of Korea were plywood and wigs -- items that were not even listed in the export statistics of 1958. It would have taken an inspired prophet to foresee a decade ago the role that these goods would come to play in providing foreign exchange resources to Korea.

One of the great virtues of a free economy is that it permits the development of the unexpected. Given proper incentives, the private entrepreneurs of South Korea found many new uses for labor, utilizing raw materials, such as wood, that had to be imported from distant lands. There were failures as well as successes, but the end result has been a rapid development of production and exports that had not been previously dreamed of, much less planned.

The lesson behind Korea's experience is an old one. Where men are given the opportunity and incentives to make and sell the products of their labor in free markets, they will tend to act in ways that increase productive efficiency and thereby raise the living standards of the country as a whole. To be sure, freedom of entrepreneurs, workers, and consumers to make their own decisions is by no means the sole determinant of how well a country will perform economically. A nation must also pursue sound monetary, fiscal, and trade policies in order to achieve the economic growth of which it is capable. But there can not be the slightest doubt, in view of the experience accumulated over centuries, that free and competitive markets are a major determinant of economic growth and widespread prosperity.

It is no accident that the Asian countries that experienced the slowest rates of growth in 1958-68 were also the countries that leaned most heavily on centralized economic controls. The countries at the bottom of the scale in terms of growth of real GNP include Ceylon, Burma, India, and Indonesia. Each of these countries has experimented extensively with government ownership or control over economic activities.

Burma in particular has gone far toward economic authoritarianism. Its government has exercised far-reaching controls over production, trade, and finance, with the result that both production and distribution have been hampered. The output of Burma's main crop, rice, has been adversely affected by pricing policies that have denied producers adequate incentives. Over the past decade, neighboring Thailand has increased rice exports by 28 per cent, while Burma's exports of rice have fallen nearly two-thirds. The result is that Burma's total exports are now running at less than half the 1963 level. The ability to import has fallen correspondingly, and the Burmese people have found it increasingly difficult to buy consumer goods that are found in abundance in neighboring countries.

Indonesia under President Sukarno followed economic policies that were in some respects more harmful than those of Burma. In addition to establishing stifling controls over production and trade, Sukarno's government borrowed heavily abroad, largely to build up a military machine, but partly also to finance ambitious projects that in the end yielded little or no economic return. The productive capital of the country was therefore badly eroded, exports fell sharply, living standards declined, and the country found itself saddled with huge foreign debts and with diminished ability to produce the exports needed to service the debt. Fortunately, Indonesia is now in process of liberalizing her economy and dismantling the pervasive regulations that were imposed on her economic structure. However, the country will require many years to recuperate from the damage wrought by the Sukarno policies.

The adverse impact of authoritarian economic policies has also been felt in India, though to a much lesser degree than in either Burma or Indonesia. India over the past decade and a half has emphasized strong centralized control over investment, backed by extensive restrictions on imports and foreign exchange expenditures. Fortunately, there is a growing recognition in India that mistakes large enough to retard significantly the rate of economic growth have been made. The earlier decisions to emphasize heavy industry at the expense of light industry and agriculture are now being questioned. The low rates of return on many government industrial investments have also raised serious doubts both about the original decisions and the management of the resulting public enterprises. The failure to provide incentives to exports has left India lagging far behind many other countries, and has contributed to balance-of-payments difficulties which necessitated ever tighter import restrictions. As a result, India has passed through a difficult period during which many of her industrial enterprises were deprived of the supplies and equipment required to keep operating at reasonable rates.

Division of labor, territorial specialization, freedom of trade, and decentralization of economic decision-making -- these were key elements in the thinking of the founder of classical economics, Adam Smith. It is gratifying to see that the practical statesmen of the world are gradually rediscovering these essential truths. In this rediscovery of truth, we owe a great deal to countries like the Republic of Korea, Japan, Nationalist China, Hong Kong, and Thailand that have most recently demonstrated how men operating in free markets can outperform authoritarianism in the economic contest.

I see in the economic experience of both the countries that have lately succeeded and those that have failed a basis for optimism about the future. What has gone wrong, after all, is not something immutable. As the case of South Korea shows, a country can change its future by changing its policies. The countries that have lagged in the economic contest have the opportunity to learn from experience and to alter their course.

The desire for economic development is a strong force in the modern world, and it deserves every encouragement. I have concentrated today on the economic framework that is conducive to rational economic growth and on the policies that are within the control of the developing countries themselves. These are of vital importance.

However, I am not unmindful of the responsibilities that fall on the large industrialized countries, including my own, to help the development process. We have, at times, overestimated our potential contribution. There has been a tendency at times to think that external technical assistance, or external capital, could of itself provide sufficient impetus to generate rapid growth all over the world. We now appreciate that the solutions are more complex. Nevertheless, technical assistance, capital flows, whether governmental or private, and liberal trade policies on the part of the industrialized countries can contribute significantly to the process of economic development. It is by no means clear that the rich industrial countries are doing all that they might along these lines.

And yet I think that the export of technology and management is by far the most important contribution that the industrialized countries can make to the developing nations. The world has never known a period in which the technical means for increasing man's productive capacity have been so readily available. The countries that will profit most from these favorable conditions are those that eschew authoritarianism, that base their economic policies on the moral concept that men can better themselves most effectively by practicing free and competitive enterprise, and at the same time pursue overall monetary and fiscal policies that guard the nation against possible ravages of both recession and inflation.

-0-