Peter Bauer's Legacy of Liberty

by
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Cato's Letters

A HERO OF THE MARKET REVOLUTION

The death of Peter Bauer on May 2, 2002, at 86 years old, marked the passing of a great economist and a hero of the market revolution that has been sweeping the globe. In recognition of his pioneering work in development economics and his lifelong commitment to the principles of a free society, Bauer was named the first recipient of the Milton Friedman Prize for Advancing Liberty, a $500,000 prize awarded every two years by the Cato Institute. Bauer was awarded the prize posthumously on May 9, at the Cato Institute's 25th anniversary celebration. At that ceremony, Milton Friedman expressed his admiration for Bauer with these words: "There are few things that are more important than to honor those people who have promoted liberty around the world, and Peter deserved that prize. A friend of mine for 50 years, he was always consistent and persistent in presenting ideas that were unpopular but correct."

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For years Bauer fought against so-called development experts who saw comprehensive central planning, protectionism, and foreign aid as prerequisites for economic advance. The collapse of communism in Soviet Bloc countries in 1989 and in the USSR in 1991, and the end of central planning in those countries as well as in China and other developing countries, were the defining moments of the 20th century from a market-liberal perspective. Those events, in particular, have vindicated Bauer's lifework.

Pieter Tamas Bauer was born in Budapest on November 6, 1915. He attended the famous Scholae Piae and then went on to study law at Budapest University. In 1934, he embarked for

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England and was admitted to Gonville and Caius College, Cambridge, where he studied economics and graduated in 1937. Bauer then returned to Hungary to complete his law degree and serve in the military. In 1939, he left to take a job in London with Guthrie & Company, a merchant house that conducted business in the Far East. Bauer began his academic career in 1943 at London University, where he was first a research fellow and then, in 1947, a reader in agricultural economics. He moved on to teach at Cambridge University in 1948 and remained there until 1960. The remainder 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 and a member of the Mont Pélerin Society.[1]

THE END AND CRITERION OF DEVELOPMENT: EXTENDING INDIVIDUAL CHOICE

For Bauer, 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. Limited government, not central planning, was his mantra. Accordingly, in 1957, Bauer wrote in *Economic Analysis and Policy in Underdeveloped Countries*:

> 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; and I judge a measure principally by its probable effects on the range of alternatives open to individuals. . . . The acceptance of this objective means that I attach significance, meaning, and value to individual acts of choice and valuation, including the individual time preference between the present and the future [Bauer 1957: 113].

[1]For a useful biographical sketch of Bauer, see Harris (2002). Basil Yamey (1987) presents an excellent overview of Bauer's work.

He went on to say, "My position is much influenced by my dislike of policies or measures which are likely to increase man's power over man, that is, to increase the control of groups or individuals over their fellow men."

"I regard the extension of the range of choice . . . as the principal objective and criterion of economic development."

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.

If economic development is to be maximized, then freedom must be maximized, which means coercion must be minimized. To do so the powers of government must be limited *to the protection of persons and property*. People will then be free to choose and expand their options provided they respect the equal rights of others. The rules of the game were important to Bauer because they helped define the choice set open to individuals. Long before it became fashionable Bauer applied property rights theory and public choice to the field of development economics.

The spontaneous market order is consistent with freedom. Any increase in the scope of market exchange naturally increases the effective range of individual choices. Likewise, any restriction of economic freedom reduces the effective range of alternatives open to individuals and hinders development, as envisioned by Bauer. Both the rich and the poor benefit from economic freedom. When law safeguards private property rights, people will specialize in ownership and risk bearing, markets will flourish, and voluntary trades will be mutually beneficial.

In his essay "Market Order and State Planning," Bauer (1984: 25) wrote,

> The market order minimizes the power of individuals and groups forcibly to

> restrict the choices of other people. Forcible restriction of the choice of others is what coercion means. Possession of wealth does not by itself confer such power on the rich. Indeed, in modern market economies the rich, especially the very rich, usually owe their prosperity to activities which have widened the choices of their fellow men, including those of the poor.

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For Bauer, the poor benefit from the freedom to choose whom to work for and where, as opposed to a centrally planned economy where workers have no such freedom. Power in the hands of government officials is more dangerous than money in the hands of rich people. Restricting capital flows and travel also harms the poor. That is why Bauer (1984: 26–27) emphasizes that "in the Third World, as in the West, the extension of opportunities presented by the market has been and is of critical significance for the poor"; "poverty is not the same as unfreedom in the sense of being subject to coercion by others"; and "a market order is a necessary condition of personal freedom."

Bauer's focus is on the *process* of development, as measured by the extent of economic freedom, not on the growth of national income. The two, of course, are related, but there are important differences. A centrally planned economy may have a high rate of economic growth (ignoring measurement problems), but people are not free to choose; oppressive government narrowly limits their range of effective alternatives. That aspect of development must not be ignored, according to Bauer (1957: 125–26).

In sum, what really matters to Bauer is freedom of choice, including the choice about how much to save and to invest: "The right of some people to force others to develop is not self-evident, particularly when a widening of the range of choice, of access to alternatives, is regarded as the principal benefit of economic development" (Bauer 1957: 122).

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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 (small-scale growers) from acquiring 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. But for the almost uninterrupted statutory restriction of the last quarter of a century, there would today be fewer landless labourers in Malaya and many more owners of small plantations. This would conduce to social stability of the country. 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].[2]

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.

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THE CHIMERA OF STATE-LED DEVELOPMENT

State-led development policy is an impossible or foolish fantasy, a chimera. Once government power is extended beyond its legitimate bounds of protecting persons and property, freedom will lose ground; the alternatives open to individuals will be considerably restricted compared to a liberal constitutional order based on limited government and private property rights. What matters for Bauer (1957: 113) is "the process by which development is promoted": a spontaneous free-market process that enlarges individual choice is the true meaning of development; a coercive, state-led development policy that denies individuals the freedom to make their own choices is pseudo development.

Given his view of what the end and criterion of economic development should be, Bauer reacted strongly to those who favored central planning. He dissected the case for planning and exposed the fallacies of those development experts who argued that the poor were incapable of lifting themselves out of poverty because of market failures.

[2]In his first book, *The Rubber Industry*, Bauer (1948b: 348) argued, "In order to make new planting feasible, there must also be liberal alienation (and on easy terms) of land. . . . Particular attention should be given to the encouragement of small ownership."

The Appeal of Central Planning

Under central economic planning, government decision-making replaces private decision-making. For that reason, says Bauer (1978: 185), "Planning . . . has obvious appeal to politicians, administrators, and intellectuals, since it creates positions of power that members of these groups expect to fill, with resulting political, emotional, and financial advantages." Moreover, planning appeals to people because they wrongly perceive the market system as "irrational and confused" while planning appears to be "based on method, reason, and science." The third reason Bauer gives for the appeal of planning is its link "to the all-embracing messianic creed of Marxism-Leninism."

The idea that socialist planners can solve the problem of poverty better than the free market was generally accepted in the Third Word, until recently. And it was mostly Western development experts who spread that idea. 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). One year earlier, Gunnar Myrdal had written, "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" (Myrdal 1956a: 201). That socialist mentality and the vision of state-led development were so ingrained that as late as 1985, after years of failure, Indian Prime Minister Rajiv Gandhi could write,

> While there is a problem of collecting, coordinating, sorting out and analyzing the tremendous amount of information needed for developmental planning at the national level, the solution perhaps lies in improving the tools of collection and analysis of data and not in abandoning the planning effort itself.[3]

[3]Quoted from a letter the prime minister sent to Cato Institute president Edward H. Crane, after Gandhi had received a copy of Don Lavoie's (1985) book, *National Economic Planning: What Is Left?*

Today, even the World Bank (1997: 1–2) admits that the notion that "good advisers and technical experts would formulate good policies, which good governments would then implement for the good of society" was naive. "Governments 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"—exactly as Bauer had predicted.

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Central Planning and Freedom

Central planning extends the power of the state by making government the overseer dictating every aspect of economic life. When people have only one employer, no property rights, no private markets to trade in, no investment choices, and free trade is a crime, there is little room for human development. All economic decisions become politicized and corruption becomes commonplace. 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. That anti-market mentality disturbed Bauer. He did not see the poor as "lifeless bricks, to be moved about by some master builder" (Bauer 1984: 5). The poor are not indifferent to their future or unresponsive to market incentives. Given freedom and responsibility, poor people are fully capable of moving themselves and their families out of poverty.

The Anti-Market Mentality of Development Experts

The mantra of development experts was that there was a "vicious circle of poverty" from which the poor could not 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: "To have money is the result of economic achievement, not its precondition. . . . Indeed, if the notion of the vicious circle of poverty were valid, mankind would still be living in the Old Stone Age."

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Bauer's experience in Malaya (now Malaysia), in the late 1940s, and in West Africa led him to recognize the importance of individual effort by small landowners and traders in moving from subsistence to a higher standard of living. 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 re-

> sponses 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: 190–91].

Bauer was among the first to clearly see that the real plight of underdeveloped countries is not market failure but government failure—that 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].

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The politicization of economic life, the loss of freedom, and the damage done to civil society under comprehensive economic planning are now well known. That is why attention is finally shifting from the model of state-led development to the nature of institutions and the role of government in fostering the spontaneous market process. As the World Bank (1997: 1) noted, "State-led intervention emphasized market failures and accorded the state a central role in correcting them. But the institutional assumptions implicit in this world view were, as we all realize today, too simplistic."

Bauer (1978: 184) points to "the belief that economic controls are necessary to shield people from the risks of the market, especially price fluctuations of export crops" as "another source of hostility to the market." To reduce that risk, many less developed countries (LDCs) in Asia and Africa set up state monopolies with the exclusive right to buy crops for export. Farmers were paid below-market prices for their crops and the state export monopolies captured the profits. The resulting tax on farmers' incomes "retarded the expansion of the exchange economy and restricted the volume of private saving, thus inhibiting the emergence of a local capitalist class." Instead of reducing risks for farmers, the controls actually increased risk by politicizing life:

> State controls have not secured stability in any meaningful sense for the farmers or other economic agents subject to them. Both controls and the consequent politicization of life involve hazards more severe and less predictable than those of the markets. After all, if agricultural prices fluctuate, it is possible for producers (or for that matter, governments) to set aside reserves. No such protection is available against the withdrawal of a trading license, the confiscation of income or property, or deportation [Bauer 1978: 185].

Those who criticize the market for its imperfections fail to consider "that market participants are people. Human beings and their arrangements cannot be faultless" (Bauer 1984: 29). The implicit assumption of market pessimists is that people in government are somehow better than people in the market order. Yet, as Bauer warns, those in government have the *power to coerce*, something that market participants lack: "In recent years, detractors of the market order have made much of instances of political pressure, or of fraud by market participants. Would it make for a better society if more people with such habits were in the government sector and thus possessed the coercive power which goes with it?"

Some people criticize the market order for failing to bring about sufficiently fast material progress. However, Bauer (1984: 29) emphasizes:

> It is not a defect of the market that it does not guarantee material progress, let alone contentment or happiness. It is a corollary of voluntary arrangements that they permit people to remain materially unambitious or to consider the cost of economic improvement excessive if that is what they wish. The market order permits them to do their own thing, to use contemporary jargon.

Perhaps the loudest criticism of the market has been that it leads to inequality in the distribution of income and wealth. Bauer addressed that criticism head-on. First, he distinguished between "inequality" and "differences," with the latter the preferred term since it is more analytical and less emotive. People differ with respect to their abilities and their character and conduct; those differences result in differences in income and wealth. Second, in a market order, one becomes rich by serving the needs of others—that is, by satisfying consumers' preferences. Those individuals who put resources to higher valued uses will do better than those who do not.

Third, there are two ways to achieve higher incomes: by force or by voluntary exchange. The market order rests on equality under the law and limited government; using the government to bring about forced transfers violates private property rights and attenuates economic freedom. Justice, properly understood, requires limited government, not a redistributive state. Critics of the market outcome thus turn justice on its head. It is not successful entrepreneurs in Western market economies who exploit the poor in the Third World, but rather their own corrupt governments.[4]

Because the attempt by governments to remove income differences ("inequality") necessarily involves the use of force, Bauer (1981: 8) saw "an underlying contradiction in egalitarianism in open societies." Indeed,

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[4]For an exchange between Bauer and Amartya Sen on egalitarianism, see *New York Review of Books* (1982).

> In an open and free society, political action which deliberately aimed to minimize, or even remove, economic differences (i.e. differences in income and wealth) would entail such extensive coercion that the society would cease to be open and free. The successful pursuit of the unholy grail of economic equality would exchange the promised reduction or removal of differences in income and wealth for much greater actual inequality of power between rulers and subjects.

Dictating equality of outcome not only destroys freedom, by discriminating against individuals or groups who are successful, but also destroys the wealth-creating properties of the competitive market process—a process that rests on the sanctity of private ownership and freedom of contract. Bauer, like the great 18th century classical liberals, recognized the important linkage between the institutional or property rights framework and the process of wealth creation. Critics of the market who ignore that linkage disregard reality.

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ON THE DETERMINANTS OF ECONOMIC DEVELOPMENT

After studying a number of LDCs, Bauer 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 [Bauer 2000: 29].

A large and growing population is not a detriment to economic progress, nor is a high population density, provided the institutional setting is favorable to freedom and responsibility. Thus, for Bauer, "Economic achievement and progress depend on people's conduct, not on their numbers." He criticized the use of national income per capita as a measure of personal welfare since "it ignores satisfaction people derive from having children or from living longer. . . . Ironically, the birth of a child is registered as a reduction in national income per head, while the birth of a calf shows up as an improvement" (Bauer 2000: 30–31).

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The Investment Fetish and Compulsory Saving

Bauer was especially critical of the argument, widely accepted by development experts, that large-scale government investment is necessary to alleviate poverty. First, investment itself is only one factor influencing economic growth:

> 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 [Bauer 1957: 119].

Second, when the state uses taxes and other measures to reduce private consumption, people can be made worse off: private investment is reduced, hence restricting the growth of the market sector; and compulsory saving reduces individual freedom. It is wrong, says Bauer, to regard "the total proceeds of compulsory saving . . . as a net addition to resources." There is a cost involved, namely, the forgone net income that could have been created if those same funds had been directed to private capital formation. Moreover, "Taxation for development [i.e., compulsory saving] normally falls on activities in the exchange sector, and is very likely to take forms which will retard the enlargement of production for wider exchange." Finally, state-directed investment and compulsory saving have a negative impact on freedom: they typically lead to "a great inequality in the distribution of power within the country," which "implies a restriction in the range of alternatives of those over whom the power is exercised" (Bauer 1957: 116–17, 124). In response to the notion that "enforced austerity is . . . necessary for a promised increase in output," Bauer (1981: 254) replies, "What right have the rulers to coerce their subjects for this purpose?" [5]

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Third, state-directed investment is notoriously inefficient because it is guided by political, not economic, considerations. The so-called investment fetish of development experts resulted in numerous large-scale projects that were monuments for the ruling elite at the expense of the poor (Bauer 1981: chap. 14). Moreover, the lack of private property rights in those investments led to mismanagement and poor maintenance. One need only look at the wasteland of the former Soviet Union and its client countries.

To think that the poor are incapable of saving and investing for the future is to ignore the lessons of history, argues Bauer. The smallholders

[5] Nobel laureate economist Gunnar Myrdal (1956b: 64) argued in his Cairo lectures: "There is no other road to economic development than a forcible rise of the part of the national income which is withheld from consumption and devoted to investments, and this implies a policy of utmost austerity."

in Malaya and the small-scale traders in 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.

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. Much of capital formation is not a pre-condition of material advance but its concomitant" (Bauer 1981: 248). Those changes are best brought about by moving toward an open society and a liberal trade policy, not by government coercion, protectionism, and foreign aid.

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The Dynamic Gains from Trade

Bauer criticized conventional development economists for neglecting the role of traders in the transition from subsistence to an exchange economy. Internal trade, in particular, is an important source of growth for LDCs, as Bauer found in his study of West African trade. The emergence of a merchant class—a class of small traders and shopkeepers—helps "to create commercial institutions and practices and to raise the level of human capital" (Bauer 2000: 4). Small-scale traders provide both marketing services and credit to their customers. Such credit provision is the last link in a long chain beginning with large financial institutions in the world capital markets. Accordingly, "There is . . . a process of bulk-breaking in the financial market; and the farmer in the hinterland has access indirectly to the world capital market" (Bauer 2000: 10). Experts who were wedded to the idea that only large-scale capital investment could end poverty in LDCs neglected those informal links and small-scale capital projects.

Mainstream development theory overlooked the dynamic gains from trade liberalization: "Contacts through traders and trade are prime agents in the spread of new ideas, modes of behavior, and methods of production. External commercial contacts often first suggest the possibility of change, including economic improvement" (Bauer 2000: 8). The availability of Western goods provides an incentive for people in LDCs to work hard, to save, and to invest in order to afford the newly available luxury goods: "It is no accident that throughout the Third World the most advanced regions are those with most Western commercial contacts; and, conversely, the most backward and poorest are those with few such contacts" (Bauer 2000: 5).

Countries that isolate themselves from the benefits of the international division of labor pay a high price: "The absence of trading links with the outside world and lack of reserve stocks turn misfortune, such as bad weather, into disaster; belt-tightening becomes starvation. . . . There is a core of truth in the jibe that the weather tends to be bad in centrally controlled economies" (Bauer 2000: 7–8).

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By opening internal and external markets to competition, governments can provide a sound basis for material progress. The problem is that entrenched interests in many Third World countries wish to maintain the status quo. Breaking up government monopolies and liberalizing trade would help the poor but injure politically powerful groups, so change is difficult. Protectionist policies retard economic growth and thus Third World governments turn to external aid as an alternative source of helping the poor. Bauer saw that approach as a dangerous detour and a dead end. The poor are doubly harmed: first by the anticompetitive effects of state monopolies and tariffs and second by the corrupting influence of government-to-government transfers.

FOREIGN AID AND THE POLITICIZATION OF ECONOMIC LIFE

While trade increases the range of alternatives to the poor, foreign aid makes them more dependent on government and politicizes economic life. Official aid is better seen as a subsidy to corrupt governments, argued Bauer, than a benefit to the poor. In his view, foreign aid is neither necessary nor sufficient for economic development—and is apt to be detrimental (Bauer 1976: 95–136). Those technocrats 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).

"The concept of the Third World and the policy of official aid are inseparable. The one would not exist without the other."

History shows that external subsidies politicize economic life and delay real reform.[6] Bauer recognized that, in making the transition from plan to market in former communist countries, it is essential to create a market-friendly institutional infrastructure. Instead of making people in the

[6]Foreign aid has been a dismal failure because economic liberty, not economic aid, is the key ingredient in fostering material advance. Bauer made that point repeatedly and recent studies support his long-held views. Bryan Johnson and Thomas Sheehy (1996: 2) found that "of the 34 long-term recipients of U.S. foreign aid ranked by the *Index* [*of Economic Freedom*] as lacking economic freedom, 26 are no better off than they were over three decades ago." Ian Vásquez examined 73 countries over the 1971–95 period and found no positive correlation between aid and economic growth. In fact, there was a slight *negative* correlation. He also found that for a group of 20 countries whose economic freedom ranking was constant or declined over the 1985–90 period, 19 of those countries had received *increased aid* as a percentage of GDP (Vásquez 1998: 276, 279).

East dependent on government aid, Western governments should demonstrate their own adherence to the market-liberal order by opening markets to the East and liberalizing trade relations (Bauer 1998).

"Official aid is, in practice, an important anti-market force."

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 benefited 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 foreign aid—"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 anti-market force" (Bauer 1978: 182–83).

Today the emphasis is on linking foreign aid to market liberalization. But if aid is neither necessary nor sufficient for economic development, the current case for government-to-government transfers is suspect. Private capital markets are fully capable of supplying sufficient funds for economic development, provided those funds are used productively and profitably in the Third World.

THE FUTURE OF MARKET LIBERALISM

The massive failure of central planning means that it is no longer a major threat to the market order. The real danger to market liberalism is the idea that the inequality of income and wealth requires corrective government action and that the West is responsible or guilty for Third World poverty (Bauer 1981: chap. 4). Indeed, it is widely believed that social justice requires greater equality in the distribution of income and wealth, which implies that significant differences in income and wealth (as determined by some arbitrary social norm) are due to "exploitation, oppression, discrimination or improper privilege; and politically organized redistribution is desirable" (Bauer 1984: 73). Such "legitimization of envy" is a major threat to an open society, in Bauer's view.

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Equality properly understood as equality under the law, whereby just rules provide equal protection to persons and property, is one of the basic principles of a market-liberal order and is fully compatible with individual freedom. What Bauer is against is not the use of force to safeguard property rights but rather the use of government power to take private property without the owner's consent for the sake of achieving some politically determined equality in the distribution of income and wealth. The further a country moves along the path of the redistributive or welfare state, the greater the *inequality of power* that will result as political decisions trump market decisions.[7]

If individuals believe that the West's wealth is the result of exploiting the Third World's resources and that trade makes the rich grow richer at the expense of the poor, then further interna-

[7]Bauer points out the confusion in thinking that differences in wealth naturally imply differences in power, in the sense of "the ability of some individuals to control others." In reality, "freedom from control or dictation is a function of access to independent alternatives, and not of equality of wealth or incomes conventionally measured" (Bauer 1957: 125, n. 21).

tional pressure will be put on Western governments to exploit the rich, in the name of social justice. When that mentality prevails, constitutional democracy, limited government, and the spontaneous market order will give way to crude majoritarianism and market socialism. That process is apparent today in the growth of the paternalistic state and the anti-globalization movement.

Bauer (1984: 35) clearly understood that "replacement of market processes by political decisions provides power, influence, jobs and money for politicians and civil servants." The challenge is to limit the power of government by a "constitution of liberty," as Hayek (1960) used the term, so that people are free to choose. To do so, however, there must be an ethos of liberty in society. Bauer's persistence and courage in defending the principles of a free society need to be continued today if market liberalism is to survive and flourish in the 21st century. The first step is to recognize the need for clear thinking. As Bauer (1984: 37) noted, "In spite of its productivity, the market order may well go under unless its participants and supporters have the clarity of thought and the will and courage to work for its survival." Bauer (1984: 89) was fond of saying, "There is profound truth in Pascal's maxim that working hard to think clearly is the beginning of moral conduct." When he was ennobled in 1982, Lord Bauer chose the motto "Let us be free from cant" for his coat of arms.

"There is profound truth in Pascal's maxim that working hard to think clearly is the beginning of moral conduct."

Bauer's legacy is that through his persistence and clarity of thought he helped us better understand the forces that shape economic development, especially the institutions of private property, stable money, free trade, and limited government—all of which underpin the market-liberal order. His "dissent on development," in which he almost single-handedly overturned the state-led development model, guarantees that he will be remembered as one of the 20th century's greatest champions of freedom.

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