

### **Mitchell James Crowe – Hardy**

The Study on Sources of Prosperity:

‘A reflection on historical conditions that lead to prosperity and whether they are prevalent in the current West Australian economy’



The economic cycle dictates that what must go up must come down. Since the late 19<sup>th</sup> century economists and governments have sought to identify the causes of economic booms (economic prosperity) and ways to avoid the peak anticipated by the economic cycle. Adam Smith's 'An Inquiry into the Nature and Causes of the Wealth of Nations' was conducted in the hope of explaining why the prosperity of nation's differed and since then other scholars have tried to add meaningful input to this topic. The economic performance of nations differs significantly, "as we near the end of the 20th century, the richest countries in the world are roughly 30 to 50 times wealthier than the poorest ones" [Jordan, J.L. 1998]. There have been many instances of 'economic miracles' over the past 200 years, however, this essay will focus on the industrial revolution in Britain, Japan's economic boom and the 'Little Dragons' in South East Asia with the aim of highlighting recurring factors that lead to these different economic prosperities and if these factors are well entrenched in Western Australia's current economic situation.

### Theoretical Background

Before this essay delves into the theoretical background of the causes of economic prosperity, it shall define the idea of 'economic prosperity'. The Oxford dictionary defines prosperity as the condition of being prosperous, successful or thriving; good fortune, success, well – being, wealth. When this is placed in an economic setting this can be interpreted as the sources that allow for a nation's economy to be prosperous. The idea of economic prosperity is not new; indeed it was this phenomenon that lead to Adam Smith's most influential piece of literature.

Adam Smith published 'An Inquiry into the Nature and Causes of the Wealth of Nations' in 1776 with the overarching aim of clarifying why there was great diversity in the prosperity of different nation's economies. In Book III 'On the Different Progress of Opulence in Different Nations', Smith outlined the importance of cities in their contribution to the improvement of countries. Commercial and manufacturing towns contributed to the improvement of countries by affording a great and ready market [Smith, Adam (1977)] and through commerce and manufacturers who gradually introduced order and good government [Smith, Adam (1977)]. From this we can derive the importance of markets and the policies of the institutions involved within them.

In 1993 James D. Gwartney and Richard L. Stroup published 'What Everyone Should Know About Economics and Prosperity' with the Fraser Institute. In this article Gwartney and Stroup identified "seven major sources of economic progress" [Gwartney, James D. and Stroup, Richard L. 1993]. Their studies lead them to conclude that private ownership, freedom of exchange, competitive markets, efficient capital markets, monetary stability, low tax rates and free trade were the seven key causes for economic prosperity. They reached this conclusion through a mixture of historical and economic inquiry. From these seven variables it can be seen that the political institutions and their fiscal policies play a significant role in an economies probability in achieving economic prosperity.

*There are two primary ways that a government can promote social cooperation and enhance economic welfare: (a) provide people with protection for their lives, liberties, and properties (as long as they were acquired without force, fraud, or theft) and (b) supply a few select goods that have unusual characteristics that make them difficult to provide through markets. Nobel laureate James Buchanan refers to these functions as the protective and productive functions of government.*

[Gwartney, James D. and Stroup, Richard L. 1993]

This idea is supported by Jerry L. Jordan, the President and Chief Executive Officer of the Federal Reserve Bank of Cleveland, in September of 1998. He stated that "it is not the specific programs government puts in place that decide [upon] our prosperity, [but] our choice of institutions... that determines our wealth and development" [Jordan, J.L. 1998]. In making this statement Jordan believed that the "most important element separating economic "haves" from "have-nots" is whether the role of an economy's institutions—and particularly its public institutions—is to facilitate, or to confiscate production" [Jordan, J. L. 1998].

From these studies we can conclude that the economic and public institutions play a significant role in determining the success of an economy. In the realm of economics controlled experiments are impossible; therefore, this essay will look at previous historical instances. This will relinquish the reliance on unrealistic variables.

### Historical Instances of Economic Prosperity

Economic studies have concluded that economic infrastructure plays a significant role in the determination of economic prosperity and hence it is considerably dependent upon political policy. For the purposes of testing this overarching idea, this essay will assess the industrial revolution in Britain, Japan's economic growth after World War II and the success of South East Asia's 'Little Dragons' as they represent periods of prosperity in different situations and periods of time. This is intended so that the factors derived from previous periods of economic prosperity are not specific to one certain economy, such as a developing nation, and can be seen as an overarching principle.

Ten years prior to the nineteenth century Britain was an agrarian society experiencing the initial stages of the First Industrial Revolution. This early stage of industrialisation has been named 'proto – industrialisation'; this term reflects the continuance of traditional production methods with a small number of manufacturers using new technology. It wasn't until 1831 that Britain had steam driven machinery.

The second industrial Revolution, and most significant industrial progression, took place in the mid 19<sup>th</sup> century. Britain, like the rest of Europe, depended on Europe's economic framework for industrial development. From 1850 to 1870 Europe experienced a significant economic boom leading to significant industrial development. In this period, Britain exported between 30 and 40 percent of the world's manufactured goods. Britain's Industrial Revolution came about as the result of several important factors; they were the dominant power in world trade, the largest industrial producer, financial centre of the world and the wealthiest nation [Roberts, J. M. (2002)]. These variables were the result of an abundance of raw materials, a significant growth in population, an established empire to trade with and an open society that encouraged investment [Roberts, J. M. (2002)].

Japan's accelerated economic growth was the product of a lucky sequence of events: Japan's acceptance of western industrialism, the establishment of MITI, the cold war and the election of Ikeda Hayato and his subsequent pro economic development policies [Entwistle, Basil. (1985)] In the wake of Japan's devastating loss, in 1945, General MacArthur (an American general in the Pacific)

saw that that their monarchy still maintained a central influence over Japan. When the cold war began in the mid 1940s Japan's relationship with America became more significant. Japan was united under the 'nuclear umbrella' with the other western nations and was seen by America as their base in Asia. In order to modernise Japan and their economy they would need to become a democratic state as the Japanese monarchy posed a significant obstacle in modernisation. In 1946 the SCAP (Supreme Commander of the Allied Powers) increased the size of the electorate to double its initial size, and included a provision allowing the right for women to vote.

MITI (Ministry of International Trade and Industry) was formed in 1949 by the Japanese government with the aim of coordinating industries to counteract the effects of the SCAP's deflationary regulations [Johnson, Chalmers (1982)]; this was achieved through formalising cooperation between Japanese industry and government. MITI aimed at synchronising private business and government aims to achieve set goals for the Japanese economy [Johnson, Chalmers (1982)].

The assistance from America gave Japan an edge over the rest of Asia. Japan was entered into the GATT (General Agreement on Tariffs and Trade) which was created as part of a bigger plan to assist economic recovery after World War II. The majority of Asia was under Socialist rule in this period of time (such as China and Vietnam) and subsequently America and the western world refused to trade with them leaving Japan the leading Asian trading partner for the western world [Entwistle, Basil (1985)]. Japan's economic prosperity can be seen as the result of beneficial international relations, government departments and government policy.

In the significant economic success of the East Asian economies known as the 'Little Dragons', the importance of institutions is made very clear. In 1991 Steven Schlosstein conducted a study of "South Korea, Taiwan, Singapore and Hong Kong" [Schlosstein, S. 1991 page 1] and identified five recurring determinants that lead to a better quality of economic institution in this region. These were; a reputable political institutions with capable courts, rules of law and an organized succession of power; low risks of expropriation; honouring of public contracts and upholding of private contracts; separation of private institutions from political pressure, and a favourable climate and infrastructure.

From these previous instances of economic prosperity it can be concluded that a stable political, legal and economic environment, advantageous global connections and a culture that encourages economic enterprise is crucial to a nation's ability to obtain economic prosperity.

#### Western Australia's Relation to Historical and Theoretical causes of Prosperity

From previous instances of significant economic prosperity and theoretical studies conducted by Adam Smith, Nobel Laureate, James Buchanan, D. Gwartney and Richard L. Stroup we can conclude that there are several factors that form a general accord of what leads to economic prosperity. These are a stable political, legal and economic environment, beneficial global connections and a culture that encourages economic enterprise. Therefore, when discussing the current situation of Western Australia's economy this essay will evaluate whether these factors are prevalent in Western Australia.

The West Australian economy is dominated by the resources and services sector. It is mostly driven by the export of iron-ore, gold, liquefied natural gas and agricultural commodities [see appendix 1]. Like Britain during the Industrial Revolution, Western Australia is rich in minerals that are needed by the global economy; subsequently, the majority of Western Australia's economy is supported by the exportation of these resources. Western Australia's overseas resource exports account for a third of the nation's total [ABS (2008)] and this significant amount of exportation is greatly aided by international trading agreements with major trading partners.

Australia has negotiated free trade agreements with the United States of America, Singapore, Thailand, Chile, ASEAN and New Zealand [DFAT (2008)] and has been in negotiations with China since 2005 [DFAT (2005)]. Not only does this display beneficial trading connections (like the Japanese and British had), but this also displays a government and local culture that is in favour of investment and economic endeavour. Western Australia also benefits from a government that is a stable democracy with an established legal and economic environment and minimal corruption. The political, legal and economic environment of Western Australia is secure and promotes international trade and economic endeavour.

When looking at Western Australia's economy it can be summarised as a developed economy with a stable political, legal and economic environment and a large supply of natural resources. Taking this

into account, Western Australia has the foundations to be economically prosperous which has been proven by the 15 years of economic growth that was experienced prior to the Global Financial Crisis in the middle of 2008.

Given the strenuous economic conditions that have been the result of the failures in the money market, Western Australia's economy will have to undergo sensitive policies in both the private and public sector that do not jeopardise its current and future wellbeing. An article in 'The Australian' was recently released on the 4<sup>th</sup> of July that highlighted the importance of the actions taken by the private and public institutions. Michael Stutchbury states that "the toxic debt build – up that fuelled the sub – prime crisis has not been worked off. It has just been shifted to government" [Stutchbury, Michael (2009) page 17]. Although the government handouts have assisted in warding off deep recession through cash handouts to families and pensioners, and the first home buyer's subsidy; "this could spell trouble when the economy revives and interest rates start to rise" [Stutchbury, Michael (2009) page 17]. Warwick McKibbin (a prominent Australian economist and board member of the Reserve Bank of Australia) argues that fiscal policy can be useful in a crisis, but, consumer confidence is critical – not the amount of spending [Stutchbury, Michael (2009)]. A survey conducted by Melbourne based firm DBM Consultants found that "almost one in two small and medium enterprises say it is more difficult to borrow now than it was a year ago" [Sibillan, Anthony (2009) page 23.]. Therefore, if the West Australian economy is to succeed and prosper after the Global Financial Crisis consumer confidence must increase and government interference with the market should decrease. Western Australia has the fundamental elements to experience economic success and therefore, if consumer confidence increases Western Australia should be able to achieve economic prosperity again.

In a recent article in the Business Review Weekly (BRW) Peter Roberts expressed that although "the short – term outlook for manufacturing may be tough...there are plenty of opportunities" [Roberts, Peter pg. 20 (2009)]. Although the Australian economy has had a significant decline in the last year, there are still opportunities in the market.

### Conclusion

Western Australia's economy has all the basic necessities of an economy that is essential to achieve economic prosperity. In the current aftermath of the 'Global Financial Crisis' it is vital that the private and public institutions focus on raising consumer confidence and reducing the level of private and public sector debt. Government handouts may have had some short term success in avoiding deep recession, however, if the West Australian economy is to fully recover and achieve strong economic growth these handouts need to end and consumer confidence needs to be restored.



Appendix 1

Australian Bureau of Statistics (2009). *Section 7: International Merchandise Trade*. Retrieved From <http://www.abs.gov.au/ausstats/abs@.nsf/Products/1367.5~Mar+2009~Main+Features~Section+7,International+merchandise+trade?OpenDocument> [9/7/2009].

19 INTERNATIONAL MERCHANDISE TRADE <sup>(a)</sup> , By major commodity: Original			
Category of the SITC	2007	2008	
	December \$'000	September \$'000	December \$'000
<b>MAJOR EXPORT COMMODITIES<sup>(b)</sup></b>			
Iron ore and concentrates	4 395 215	9 436 358	8 982 022
Gold, non-monetary	2 837 507	3 954 843	4 020 785
Natural gas	1 180 347	1 721 854	2 688 677
Confidential items	2 281 368	1 586 108	2 249 564
Crude petroleum oils	2 255 066	2 938 254	2 048 321
Wheat	307 711	594 452	673 128
Nickel ores and concentrates	180 324	274 706	310 870
Liquefied propane and butane	235 334	207 952	216 229
Live animals	103 946	119 622	145 344
Refined petroleum oils	176 022	115 078	127 108
Ores and concentrates of base metal	299 515	151 307	110 218
Nickel	231 163	175 572	100 344
Pigments, paints, varnishes and related materials	94 163	72 262	94 679
Wool and other animal hair	77 323	47 707	70 192
Crustaceans, molluscs and aquatic invertebrates	45 201	46 513	65 302
<b>Total exports<sup>(c)</sup></b>	<b>16 126 050</b>	<b>22 887 121</b>	<b>23 743 393</b>
<p>(a) Care should be taken when comparing with commodities data prior to July 2005. For full details about changes to international trade statistics, users should refer to the Information Paper: Impact of introducing Revision 4 of the Standard International Trade Classification, 2008 (cat.no. 5368.0.55.10).</p> <p>(b) Free on board (f.o.b.) value.</p> <p>(c) Includes categories not listed.</p> <p>Source: ABS data available on request, <b>International Trade in Goods and Services, Australia</b>, cat. no. 5368.0.</p>			

## Bibliography

- Australian Bureau of Statistics (2008). *Australian Economic Indicators*. Retrieved from [http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/34CE7FFF9776F3F1CA2574B30017CFB2/\\$File/13500\\_sep%202008.pdf](http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/34CE7FFF9776F3F1CA2574B30017CFB2/$File/13500_sep%202008.pdf) [2/7/2009]
- Australian Bureau of Statistics (2009). *Section 7: International Merchandise Trade*. Retrieved From <http://www.abs.gov.au/ausstats/abs@.nsf/Products/1367.5~Mar+2009~Main+Features~Section+7,International+merchandise+trade?OpenDocument> [9/7/2009].
- DFAT (2005). *Australia – China FTA Negotiations*. Retrieved from [http://www.dfat.gov.au/geo/china/fta/050526\\_subscriber\\_update.html](http://www.dfat.gov.au/geo/china/fta/050526_subscriber_update.html) [20/6/09]
- DFAT (2008). *Free Trade Agreements*. Retrieved from <http://www.dfat.gov.au/trade/ftas.html> [22/6/09]
- Entwistle, Basil. (1985). *Japan's Decisive Decade: how a determined minority changed the nation's course in the 1950's*. Grosvenor Books: London.
- Gwartney, James D. and Stroup, Richard L. (1993).
- Johnson, Chalmers (1992). *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925 – 1975*. Stanford: Stanford university press.
- Jordan, J.L (1998). *Sources of Prosperity*. Taken from [http://www.minneapolisfed.org/publications\\_papers/pub\\_display.cfm?id=3599](http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=3599) [21/6/09]
- Roberts, J.M. (2002). *The New Penguin History of the World: Fourth Edition*. Penguin Group: London.
- Roberts, Peter (2009). *Profit Factories*. Business Review Weekly: Volume 31, no. 27.
- Schlosstein, Steven (1991). *Asia's New Little Dragons: the Dynamic Emergence of Indonesia, Thailand, and Malaysia*. Chicago: Contemporary Books.
- Sibillin, Anthony (2009). *A Time to Innovate*. Business Review Weekly: Volume 31, no. 25.
- Smith, Adam (1977). *An Inquiry into the Nature and Causes of the Wealth of Nations*. Chicago: University of Chicago Press; Facsimile of 1904 ed edition.
- Stutchbury, Michael (2009). *A Splurge Too Many*. The Weekend Australian: Weekend Inquirer July 4<sup>th</sup>- 5<sup>th</sup> 2009.