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Investment Considerations Concerning Productivity and Societal Wealth

Over the last few months we created a somewhat exhaustive series of pieces, which attempted to answer the following questions:

- Why is the standard of living higher in one country relative to others?
- What creates “social wealth” – over long periods of time, what are the consistent variables which increase societal wealth and consequently “better” and longer life spans for the citizens of those societies?

These pieces (*The Wealth of Nations – 6/23/14*, *The Wealth of Nations Part 2 – 6/30/14*, *The Wealth of Nations – A Historical Quantum Shift – 7/14/14* and *Slow Growth is a Choice – 7/21/14*) are

all available for viewing on our website www.marinerwealthadvisors.com. These pieces go into some degree of detail, outlining common societal economic structures which have led to increased per capita “real” productivity, and consequently wealth creation.



William Bernstein’s work *The Birth of Plenty* goes into great detail as to these thoughts. His work has found that there are four consistent “attributes” which are very basic in concept but complete in their reach and which historically have acted as catalysts that spur a society to experience much higher per capita productivity growth than other societies.

The four “factors” which have been highlighted as drivers behind a high level of economic productivity (highlighted in Richard Bernstein’s work *The Birth of Plenty*) are as follows:

- Acceptance of the scientific method for decision and research processes.
- An efficient transportation system (both physical transportation and the transportation communication).
- The existence of public capital markets.
- The acceptance by governmental entities that private property rights are basic and real.

One can make the case effectively that the first three of these conditions are “pre-requisites” of any society to maximize or grow productivity and consequently social wealth. ***I suggest the fourth condition (acceptance of the rights of private property) acts as a “governor” as to how rapidly the first three conditions are allowed to become effective.***

Along these lines, it makes sense to not only focus on societies where all four standards are currently in existence, but to focus on the *rate of change of the fourth factor – that being the acceptance by governmental entities that private property rights are basic and should be nurtured.*

I now ask the question - ***how can investors take advantage of countries which are taking the correct steps to enhance their economic productivity in the future? How do we measure the current status of countries which are societally improving their recognition of property rights and consequently have the ability to commence generating higher levels of societal wealth and increased standards of living?***

The Heritage Foundation

Heritage Foundation publishes an annual ranking of countries' level of economic freedom. This study is serious in nature, and is used by many leading-edge money managers to summarize social/political and economic changes (be them positive or detrimental) of 178 individual countries. The study has a 20-year track record. Of note, it is interesting to view one country's perceived level of economic freedom as compared to another, but perhaps from an investor's view, ***the cutting edge issue is one of improvement, rather than one of absolute level.*** Risk-based asset valuations may reflect existing conditions while the change in the future is what may drive market returns as those changes unfold.

So, what exactly is "economic freedom"? According to the folks at the Heritage Institute:

"Economic freedom is the fundamental right of every human to control his or her own labor and property. In an economically free society, individuals are free to work, produce, consume and invest in any way they please. In economically free societies, governments allow labor, capital and goods to move freely, and refrain from coercion or constraint of liberty beyond the extent necessary to protect and maintain liberty itself."

In other words, the definition of economic freedom, according to the folks who put together the Index of Economic Freedom, is essentially the same as our bullet point #4 above – the acceptance by governmental entities that private property rights are basic and real.

To dig a little deeper, one might ask of Heritage Foundation: what are the benefits of economic freedom? According to their website:

"Economic freedom brings greater prosperity. The Index of Economic Freedom documents the positive relationship between economic freedom and a variety of positive social and economic goals. The ideals of economic freedom are strongly associated with healthier societies, cleaner environments, greater per capita wealth, human development, democracy, and poverty elimination."

Again, directly in line with our fourth bullet point from William Bernstein's work.

The Envelope, Please

So, what has our work uncovered? According to the Heritage Foundation's 2014 Index of Economic Freedom, what are the 5 most economically free countries, and what are the 5 least economically free countries?

It is important to note that the following countries are not ranked: Afghanistan, Iraq, Kosovo, Libya, Liechtenstein, Somalia, Sudan and Syria.

Many would view the countries listed on the left as progressive countries where one wouldn't mind living. If presented with an alternative, few would likely choose to live in the countries listed in the

5 Most Free Countries	5 Least Free Countries
Hong Kong	North Korea
Singapore	Cuba
Australia	Zimbabwe
Switzerland	Venezuela
New Zealand	Eritrea

right column.

Investing in Freedom and Growth

As a capitalist and an asset allocator, next I would like to provide some thoughts as to areas of the world that make sense to invest capital, given all that I have brought forward.

Highlighting the “known-knowns” – the countries where growth and wealth creation has already occurred (the countries on the left column) is a fine idea

– but capital markets reward those who invest where the improvements will and/or are occurring rather than where the improvements have already occurred. We need to create a list of countries with investable markets where economic freedom is improving.



Emerging vs. Developed

Following is a list (non-exhaustive) of emerging and developed economies and their current economic freedom ranking in relation to their ranking as of 5 years ago. This gives us an idea as to broad-based trends between developed and non-developed economies and changes in their levels of economic freedom.

Developed Economies	5-Year Change	Emerging Economies	5-Year Change
United States	-6.3%	India	+4.7%
Japan	-0.4%	South Korea	+4.7%
Germany	+4.3%	Indonesia	+10.0%
United Kingdom	-5.1%	Peru	+4.3%
France	+0.4%	Egypt	-8.6%
		Malaysia	+7.9%
		China	-1.5%
		Nigeria	-1.4%
		Philippines	+6.3%
		Vietnam	-0.2%
Average of Above	-1.4%	Average of Above	+2.6%
Global Average	+1.3%	Global Average	+1.3%

In the table above, the list on of the left, the five largest “developed” economies in the world, have shown an average decrease in economic freedom over the last 5 years by 1.4%, led by the United States. The list on the right, all “emerging” economies, have shown an average increase in economic freedom of 2.6% over the last 5 years, led by improvements in Indonesia. As can be seen, in relation to the global average, the list on the right has seen a positive rate of change 2x that of the average country on a global scale.

Bottom Line

Overall, the point is many long-term oriented investors need to focus their attention on areas where economic and societal wealth creation has the higher chance of improving. It appears that well-selected emerging economies fill that role effectively.

Just For Fun

Following are a few thoughts from others on the topic “economic freedom”.

Our economic freedom is founded on individual property rights; government should never be permitted to take those away.

Ernest Istook

I studied what principles under-laid peace and prosperity and concluded the only way to achieve societal well-being was through a system of economic freedom.

Charles Koch

And finally...

True individual freedom cannot exist without economic security and independence. People who are hungry and out of a job are the stuff of which dictatorships are made.

Franklin D. Roosevelt

We will be back next week.



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