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| Special Economic Zones  In Theory and In Practice | Abstract  Certain zones across the world are subject to special conditions, with the goal of fostering economic prosperity. Those zones that follow the Smithian prescription of “peace, easy taxes, and a tolerable administration of justice” flourish- both in theory and in practice.  Daniel Amico  Austrian Student Scholars Conference 2014 |

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Some countries are host to wealthy, prosperous societies; other countries have stubbornly resisted every attempt at economic advancement. Then there are those odd cases, those anomalous instances, where-within an economically poor country-there is a region that defies the trend and thrives. The small Chinese coastal city of Hong Kong is one of the most economically free places on earth, and its inhabitants enjoy all the accoutrements of a modern 1st world society. What factors make this one region thrive, while others languish? This line of inquiry into the nature and cause of economic prosperity is not new. Adam Smith first examined the cause of wealth over 200 years ago. He identified, “peace, easy taxes, and a tolerable administration of justice” as the conditions necessary for economic prosperity (Boettke p.1). Both in theory and in practice, the implementation of Smithian conditions result in economic prosperity.

As of 2005, an estimated 3,000-5,000 areas of the world were designated as special zones where countries could conduct radical policy experiments to create the ideal conditions for prosperity. These special economic zones (SEZ) enjoy special benefits in the form of exceptions from various taxes and regulatory impositions (Moburg, 2013 p. 5-6). Successful SEZ offer a unique opportunity to examine the conditions conducive to economic prosperity, in a single country and culture whose economic performance is otherwise unremarkable. Examining these instances will help elucidate why and how Adam Smith’s prescription for economic prosperity works and how policy makers can successfully replicate those conditions in even the most blighted areas of the world.

The Smithian formula calls for a regime of private property, limited intervention and limited legal privilege. In the absence of disruptive interventions, prices convey information more accurately. This in turn gives entrepreneurs latitude to invest and operate in an environment largely free from price manipulations and regulation that calcify and cloud the capital accumulation and reallocation process.

**In Theory**

Although the nature of entrepreneurial activity doesn’t change when Smithian conditions are absent, the positive effect of entrepreneurial action may become muted. Their impact on the economy can either be limited in scope or “transformative in terms of economic development” (Boettke p.3 and Moburg, 2013 p.1). When entrepreneurs face a setting in which prices consistently convey meaningful and accurate information, they are able to most easily coordinate production and grow the capital stock. Where the entrepreneur has less uncertainty to account for, the risk and cost associated with undertaking economic activity decreases. If one is working under a stable and predictable regime of private property, where prices convey accurate information, and government interventions are as few and unobtrusive to the market process as possible, economic progress will be forthcoming (Boettke p. 12-13 & 19).

Establishing a pro-entrepreneurial environment takes time, and any potential sources of market intervention and legal irregularity must signal a credible commitment to refrain from taking part in market interventions in the long term (Romer, 2009 video and Boettke p.19). If these light-handed conditions are maintained without notable expansion over time, any remaining abrogating effects from state intervention will eventually dissipate (Lavoie). Don Lavoie notes, that as interventions hamper market mechanisms, the market responds in turn by evolving around these barriers in a substantive way (Lavoie, 1982 p.177-178).

Lavoie’s insight is supported by what Paul Romer calls “Myron’s Law”, which can be seen as an application of the Laffer Curve (with a time element added). Opportunistic attempts at evasion from rules and impositions will eventually reduce the effect of those impositions to a negligible amount. Stated more directly, Myron’s law claims “asymptotically, any finite tax code collects zero revenue” (Romer p. 2-3). A Smithian government limited in its scope, in the magnitude of the impositions it places on the market and the rate at which those impositions are introduced, exert much less of an abrogating effect than first glances would suggest. It’s in this predictable environment that the entrepreneur’s ability to organize production has the greatest positive impact. Under such a system, prices convey all information essential to the entrepreneur.

Price systems are only meaningful under a regime of private property which allows for trade and subjective valuation based on the imputation of value (Mises, 1998 p. 92 & 96). Trade against a medium of exchange establishes prices as ratios that convey information about relative demand for tradable property. Economic calculation allows for coordination of production, where the value of alternative uses of capital goods can be assessed so that the most highly desired items are produced (Mises, 1998 p.208-9 and Boudreaux). The information conveyed in prices is not articulated in any way that makes central planning feasible. Market conditions are always changing and rely on the dispersed knowledge of local experts. Thus the constant, free movement of prices is essential to their function (Hayek and Mises, 1998 p.207). Prices guide production and the economizing of resources, so that capital goods are driven to be used for their most highly valued end in a dynamic and complex environment (Hayek and Boudreaux and Mises, 1998 p.210-11). Hayek was the first to popularize this idea that prices convey vital market-coordinating information.

Hayek illustrates the power of prices using an example from tin production. When the price of tin increases, be it from a plant or mine shutting down or an increase in demand for tin, the workers at the facility have all the relevant knowledge they need for action given to them in that price change. The current stock of tin has now become more valuable to consumers and its price is bid up. The increased profit that the facility could gain from increased production conveys this information. In order to capture this increased profit opportunity, they increase output to meet the needs of consumers willing to bid for the smaller supply of tin more aggressively. Meanwhile, the price increase informs those down the chain of production that tin is relatively more scarce, they can either pay more to bid away tin supply from alternative uses, or substitute a more abundant material (Mises, 1998 p. 207 and Hayek).

Under Smithian economic conditions, prices are not unduly interfered with by high taxation, expensive and unexpected regulation, or war (Rothbard, 2009 p. 909). Entrepreneurs under these conditions are able to use prices when allocating resources to their most highly valued ends.

When economists talk about the entrepreneur, they are referring to an individual who, “organizes, manages, and assumes the risks of a business or enterprise” (Sobel). Entrepreneurial activity is risk-bearing in nature because production takes time (Mises, 1998 p. 105-108). Profits are generated by combining resources in novel ways, so as to anticipate and be prepared for future demand for such items. There are a number of ways this process can be understood.

Neoclassical economists regularly look at human behavior, and describe it in terms of rational maximization and market equilibrium. They ask why the Austrian methodology of human action is necessary when both approaches have seemingly similar explanatory power over the same set of contingent facts. There have been various attempts by Austrians to address this problem-dubbed the “Walrasian Box” (Rothbard, 1987 p. 97-98).

Schumpeter was influenced by the general equilibrium models of Walras, yet sought an explanation of entrepreneurial activity that laid outside the Walrasian Box. His entrepreneur is an “innovator who implements change in an economy by introducing new goods or methods of production” (Boudreaux). Schumpeter began by conceiving the economy as in an equilibrium state, with an interest rate of zero. This means that time preference and savings don’t exist, and there are no interest return on investments. Equilibrium was seen as perpetual until an exogenous infusion of bank credit was introduced, allowing entrepreneurs (the soul receivers of these apparently unbacked loans) to fund innovation. These innovations made old goods and production methods irrelevant and unprofitable. The entrepreneur moves the economy from equilibrium to equilibrium through a process of creative destruction. Since equilibrium is ultimately broken by exogenous factors, one commentator, Rothbard, concludes that Schumpeter failed to generate a true alternative to equilibrium analysis (Rothbard, 1987 p. 102-103).

Kirzner, an Austrian School economist, was able to conceive of the entrepreneur outside of a general equilibrium framework. He describes the entrepreneur as one who serendipitously discovers innovations through a process of alertness. In other words, Kirzner’s entrepreneur, “knows where to look for knowledge” (Boettke p.6). This alertness means that the entrepreneur is able to use knowledge of past errors to hone his alertness to potential, unfulfilled, arbitrage opportunities. The goal of Kirzner’s elucidation was to describe the entrepreneurs’ role in a market clearing process (Kline, 2010 p. 102-103). Unlike Schumpeter, Kirzner’s entrepreneur crates value in an explicit “means-ends framework”, complementary to the Austrian understanding of human action, not a function of exogenous factors (Klein, 2010 p. 101).

Much like the *a priori* nature of the means-ends framework of human action, Kirzner’s framework for understanding the entrepreneur is given in the terms of synthetic, *a priori* statements (Boettke, 2006 p. 250). Apart from experience, the idea that entrepreneurs can identify “objective, exogenously given, but not yet discovered opportunities” can be known and verified through reflection without observation. Kirzner’s explication of human action is a valid description of the specific discovery process that all entrepreneurs partake in (Boettke, 2006 p.104-105 and Boettke p. 7-8 and Klein, 2010 p. 259-262). These opportunities can be realized serendipitously in the mind of the entrepreneur, but they cannot be brought to fruition without time and therefore cannot be realized without time or effort.

Since the realization of opportunities occurs in the mind of the entrepreneur, the valuations are inherently subjective, but in order to see the revealed preferences of the entrepreneur, one must wait for production to occur (in which costs are incurred). For this reason, Kirzner’s description of the entrepreneur can only be *a priori* in nature, because only after the entrepreneur starts acting on his discovery does he open himself up to the risk of loss and possibility of profit (Boettke, 2006 p. 254).

The nature and expression of the risk and uncertainty that the entrepreneur assumes in production is quite nuanced, and contested. Some economists embrace subjective expressions of expected utility, arguing that a statement of probability is an adequate expression of uncertainty. Other economists insist that a proper understanding include objective statements of probability (Langlois, 1998 p188-122). Austrians, understanding the wide-reaching significance of the temporal setting of human action reject both approaches in favor of a radical understanding of uncertainty (Klein, 2010 p.124). An articulation of a framework of probability presupposes information that cannot possibly be had. Probability presumes knowledge of a range of fully articulated possible states of the world, with uncertainty being expressed over which one will be actualized (Boettke, 2006 p.254-255 and Langlois, 1998 p. 188 & 122). Since the future is fundamentally unknowable, and we cannot be certain that any articulated possible future will pan out as imagined, there is a structural uncertainty to all entrepreneurial decisions. Even the articulation of possible future states are not without uncertainty themselves (Langlois, 1998 p.118-122 and Klein, 2010 p.118). The future is not certain, and thus imagined future states cannot somehow be articulated with more certainty, even if that uncertainty is expressed probabilistically. Because the future is not certain, the role of the entrepreneur becomes that much more important and awe inspiring, as it’s their role to order heterogeneous capital to produce goods in the present to sell in an uncertain future.

Capital accumulation and production is a complex intertemporal process whereby entrepreneurs invest present resources in order to produce goods for future consumption. The intertemporal nature of production highlights the importance of the entrepreneur’s role as bearer of risk and uncertainty. One way the price mechanism helps entrepreneurs account for future conditions is through the presence of the interest rate. The interest rate is the price of future money (Mises, 1998 p.458-459). Since humans are temporal beings, there is a preference for current over future money (Mises, 1998 p. 62-64 & 624-627). The interest rate is an expression of societal time preference, the prevailing rate at which future money is discounted (Mises, 1998 p.624-627). Without interest rate manipulation, the interest rate signals the willingness for consumers to save their money in the present and use that money to fund consumption in the future. Saving facilitates the buildup of the capital structure, as capital is accumulated and makes labor more efficient, even greater magnitudes of savings are made possible (De Soto, 2009 p.301-302). This simple process of saving and investing, although it takes many forms, is the key to economic progress and capital accumulation (De Soto, 2009 p.300-301).

A low interest rate makes it easier for entrepreneurs to borrow from capitalists as it signals a willingness to save-the stock of loanable funds is high. Because capital is more mobile in the economy than labor, capitalists can rapidly capitalize those projects that generate favorable rates of return over and above the prevailing interest rate (Sobel). In the absence of an active central monetary authority or restrictions on capital, entrepreneurs are able to allocate capital in a way that lengthens the structure of production in an economically sustainable way (Mises, 1998 p. 565).

Entrepreneurs organize capital now, in order to reap the benefits later. This is not just a short-term activity. Car manufacturers, real-estate developers and construction companies can take years for their projects to see fruition. World capital markets are so vast, projects that offer a desirable rate of return will attract sufficient capital when entrepreneurs deem production profitable.

Capital markets and banks pay a vital role in capitalizing entrepreneurial endeavors. Banks connect savers with investors by providing a place for intertemporal exchange of funds to take place. The pooled savings of those with low time-preference are guided to the most promising entrepreneurial enterprises of those who might not have otherwise had private funds enough to fulfill their project. The bank, as middle man, enables for a division of labor of sorts. Instead of individuals exchanging money on a one-on-one basis, the bank intermediates the exchange and assume the risk associated with selecting worthy ventures (Rothbard, 2009 p.378-379). The interest rate is an incredibly subtle and integrated form of market-coordinating information, which is as important for capital accumulation as accurate price formation.

**In Practice**

SEZ are characterized by attempts at market liberalization, which serve to make capital accumulation easier. This is not always the case in practice. Countries may impose onerous-purpose defeating- requirements on SEZ such that they, “resemble state planned industrial clusters, rather than liberalized free zones” (Moburg, 2013 p.5). Such regulations can stipulate type of production, degree of foreign investment tolerated, and minimum employment requirements. These conditions are antithetical to the instalment of a Smithian regime. In the developing world, SEZ have been haphazardly established and duly criticized. When establishing SEZ, governments frequently expropriate farmland and modify it for development. The displaced farmers are not adequately compensated for their loss. This is a violation of property rights, and even if done to establish a SEZ, such action undermines the price system and creates uncertainty in property owners.

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| The World Bank Doing Business Index | | | |
| Country  2014 Ranking | Hong Kong 2 | United States  4 | China  96 |
| Starting a Business |  |  |  |
| Procedures (number) | 3 | 6 | 13 |
| Time (days) | 2.5 | 5.0 | 33.0 |
| Cost (% of income per capita) | 0.8 | 1.5 | 2.0 |
| Trading Across Borders |  |  |  |
| Documents to export (number) | 3 | 3 | 8 |
| Time to export (days) | 6 | 6 | 21 |
| Cost to export (US$ per container) | 590 | 1,090 | 620 |
| Documents to import (number) | 3 | 5 | 5 |
| Time to import (days) | 5 | 5 | 24 |
| Cost to import (US$ per container) | 565 | 1,315 | 615 |

(Doing Business)

When businesses must be granted access to SEZ, they are willing to sink massive rent-seeking costs to gain access to SEZ that hold economic potential (Sharma, 2009 p.20). Companies applying for access to Indian SEZ are filtered through an average of 15 separate authorities before setting up shop (Moburg, 2013 p.16). More than 60% of firms applying for entry into Indian SEZ have faced “irregular payments”, requests for bribes, from various government authorities for access to SEZ (Moburg, 2013 p.16). In Senegal and India, SEZ were declared in economic areas far afield of adequate infrastructure. Outside of a market process, entrepreneurial judgments simply cannot be made and profitable economic activity cannot be ordered. Similarly, the Pilipino government set up a SEZ in Bataan; providing the region with modern infrastructure, a dam and modern office buildings. The zone failed to attract any significant level of business, as it was chosen without any reference to the knowledge in the price system. It has since been deemed a failure (Moburg, 2013 p. 2). Hong Kong has succeeded so dramatically because it has avoided many of these pitfalls, baffling development planners, who see only the struggling of developing economies.

Hong Kong is an anomalous stick in the eye to prevailing economic wisdom. Hong Kong imports its oil, mineral, and water resources, and has poor soil unsuitable for agriculture (Bauer, 2000 p. 109 & 113). Additionally, the governing authority doesn’t “protect” native industry with high tariffs or restrictions on capital exports (Bauer, 2000 p.111). The social services provided by the local authorities are targeted, politically hard won, and frugal-at least relative to western standards. (Bauer, 2000 p.110-111). These conditions alone would flag Hong Kong as an impoverished backwater in desperate need of international development assistance.



(2013 Index of Economic Freedom)

As early as 1980, iconoclast development economist, Peter Bauer was attributing Hong Kong’s success to its environment of low taxes, light regulation, and minimal trade restrictions- truly a Smithian regime (See chart entitled “The World Bank Doing Business Index”). Hong Kong scores highest on the Heritage Foundation’s Index of Economic Freedom, and is the most economically free place on earth (See the cart entitled “Heritage Foundation Index of Economic Freedom”). Additionally, across an array of key areas, the extent to which Hong Kong outpaces even the US is remarkable (See chart entitled “CIA World Factbook”). Even though Hong Kong has not been subject to any notable development planning schemes, there are those who interpret its rise as the result of development planning.



(CIA World Factbook)

Development planners see Hong Kong as a test case for a new type of economic planning, deemed the “Asia Model”. This model highlights the government’s supposed role in identifying and propping up industries with high growth potential. This view holds that targeted subsidies, loan guarantees, and tariffs were successful catalysts for economic prosperity in the region (Powell, 2005 p. 306). They point to the success of the Japanese and Korean automakers, and the Hong Kong financial sector and various leading electronics manufactures in the region. Attempts by development planners to claim success for Hong Kong are not satisfying. (Powell, 2005 p.307 and Moburg, 2013 p. 11)

Claims about the success of development planning in East Asia are exaggerated, if not false. Planners face a knowledge problem, as market conditions are constantly changing, requiring a dynamic structure of production, reactive to consumer demands. Planners cannot guide markets when they claim to have more information available to them than that which the market economy actually provides (Powell, 2005 p. 308). Development planners might admit this, but they point to the success and growth of Asian companies that have received loans and subsidies, implying those programs are primarily responsible for later success. When governments allocate resources, and enrich projects that market forces had yet to allocate funding to, society becomes relatively worse off. Just because an industry received aid and was eventually profitable, it doesn’t follow that the program was enacted at the correct time (Powell, 2005 p. 309). One needs only to look at the contemporary government investment in electric car technology to see this is the case. When and if electric cars gain prominence, it will not be due to decades of industry support programs, but because that industry was finally serving demand in a profitable and sustainable way.

Development planning did exist in Hong Kong, but the extent was extraordinarily limited. Throughout the 70s, 80s and 90s, when such programs were enacted Hong Kong maintained world-beating economic freedom levels (Powell, 2005 p. 316-318). Any development programs planned for Hong Kong were unprecedentedly slight. Let alone that such an “Asian Model” program simply doesn’t have the capacity to increase economic prosperity (Powell, 2005 p. 316-318).

Strictly speaking, Hong Kong is not a Special Economic Zone, but a Special Administrative Region. The Hong Kong government has unparalleled autonomy in domestic matters, but its foreign policy is dictated from Beijing. From an economic standpoint, the Hong Kong SAR is very similar to surrounding SEZ, and shares many characteristics with them. (Moburg, 2013 p. 5-6 & 16-17). The environment of economic freedom that Bauer identified in 1980 persisted as early as 1880.

The history of Hong Kong goes back to the 1880’s and its days as a British colonial port in the midst of a China that was otherwise closed off to international trade and foreign involvement. Under British control, the port of Hong Kong became a key gateway for the opium trade, and other goods (Carroll, 2007 p. 47). From 1843, Hong Kong was governed by British royal governors, under a regime of British Common law and Chinese Customary law. From the beginning, this arrangement was overly complex, and the colonial government favored British interests over native. After struggles for reform, 1894 brought a ground shift in governance whereby government was light (lighter than any other British colony at the time) and gave specific deference to the Chinese natives, be they residents or immigrants into the British controlled area (Carroll, 2007 p.67).

Hong Kong’s development was stifled under Mao’s rule, as interference was seen as a foreign policy liability, inviting British and US involvement. A mere simmering passive aggrieve policy towards Hong Kong was seen as the most productive for Mao’s regime (Carroll, 2007 p. 138 & 176). The Chinese communists went so far as to refrain from fomenting labor strikes or proletarian unrest, for fear of nationalist backlash that would aid Chiang Kai-Shek. Through its history, the Chinese residents of Hong Kong have thought of themselves as Hong Kongese, they’ve had direct influence over their domestic affairs (Carroll, 2007 p. 209). Under Deng Xiaoping’s reforms, this continued to be the case, even as legal control of Hong Kong was wrested away from the British (Carroll, 2007 p.167 & 187). Through a joint declaration in 1984, Hong Kong emerged as a Special Administrative Region of the PRC under the “two systems, one country” arrangement (Carroll, 2007 p. 181-3). This system preserved Hong Kongese regional autonomy and it’s nearly 100 year tradition of British Common law.

Hong Kong’s heritage as a colony and lack of natural resources are key factors which encouraged such a liberal economic order. Lack of natural resources made Hong Kong immediately reliant on trade. As such, the ill-effects of trade restrictive policies were immediately and sharply felt (Caplan, 2008 p.190-194 and Bauer, 2000 p. 111). British colonial governments were unable to run deficits for any long period of time, or engage in fiscal stimulus. The colonial government was administrated by British appointees, leaving no place for career politicians and interest groups to pursue their ambitions. Instead, the city was remarkably focused, not on colonial-racial divisions, but on trading and maintaining competitiveness. Hong Kong’s colonial history does not play host to any sort of violent uprisings against the colonial administration. (Bauer, 2000 p. 113). The necessity of trade, and norms of British colonial rule helped inculcate a robust system of governance along Smithian lines that persists to the present.

A distinctive and pronounced Hong Kong identity has been forged by the vastly different economic systems of the SAR, and mainland China. While the rest of China struggles with corruption, Hong Kongese pointedly tout their commitment to anticorruption. A string of high-profile anticorruption efforts were made in the ‘70s, focusing on police and bureaucratic corruption. Since that time, Hong Kong consciously seeks to distinguish itself from the generally more corrupt PRC, and to serve as standing proof that corruption is not a uniquely Asian problem-a charge that was continually leveled in the 1950’s while Hong Kong was still under British administration. (Carroll, 2007 p. 172-173). Hong Kong residents pointedly flaunt their western-levels of consumerism, as such behavior clashes with traditional Chinese values and the austere socialism of the PRC (Carroll, 2007 p. 168-169).

Hong Kong maintains impressive levels of civil liberties, considering it has been under formal Beijing control since 1997. Proof of this can be found in the number of protests that occur daily, including open criticism of Beijing. Hong Kong residents overwhelmingly see themselves as politically and culturally distinct from the rest of China (Carroll, 2007 p. 235). Some SEZ have autonomy in the same manner of the Hong Kong SAR. Shenzhen has notably high levels of self-government and a sense of unique identity akin to that found in Hong (Moburg).

Shenzhen is a SEZ, established under Deng Xiaoping’s rule. At its formation in late 1970, it was the largest SEZ in existence at 3 square miles (Hao p. 145-149). The area has since become a thriving financial center. Even the executive Chair of the Financial and Economics Committee in the NPCC traces Shenzhen’s success to the economic freedom allowed in the SEZ. Among these are low taxation and tax exemptions for up to 10 years for new enterprises (Hao p. 145-149). There are also no tax penalties placed on the movement of capital offshore. The businesses there are able to sell their products domestically and partake in joint ventures with Chinese companies. There are no immigration restrictions between Shenzhen and Hong Kong. Additionally, international travel clearances for Chinese citizens can be processed and expedited by the Shenzhen local government (Hao p. 145-149). Another interesting key to growth which is identified is tying size of bank deposits to loan availability. Bank reserves are very high in Shenzhen for this reason. (Hao p. 145-149). These liberal economic conditions contribute to Shenzhen’s remarkable economic performance (Moburg, 2013 p.16-17).

Shenzhen and the economically similar Hong Kong SAR, have achieved remarkable success in China. The ultimate test of success is the zone’s ability to positively affect the economy over the long term- a test that these areas have unequivocally passed (Moburg, 2013 p.16-17). Looking to replicate Chinese success, other countries have established SEZ, hoping to bring about increased employment and growth in economically depressed and isolated areas.

One of the reasons that the locality of Hong Kong has remained so economically free, and why it’s so cautious at implementing a social safety net, is because the voters and taxpayers of Hong Kong bear the costs of their actions more directly than those voters and taxpayers in larger areas. Because of its early reliance on imports and trade, any deleterious economic policy’s effects were acutely felt (Bauer, 2000 p. 111 & 113). This sort of feedback mechanism keeps Hong Kong from engaging in a host of detrimental policies that would undermine its economic performance.

The social safety net in Hong Kong, and the implementation of a minimum wage were the result of hard-won political battles. Even then, these policies are very restricted and targeted. One cause of the prudence of Hong Kong’s electorate and the restraint of its political leaders can be explained as a function of the size of Hong Kong. Hong Kong is an autonomous locality with an elected government. Because of its small size, the individual members of the electorate have more of an effect in deciding policy (through their vote). This means they are more likely to act rational instead of *rationally ignorant*. If there is a small chance your vote matters, you will more likely vote emotively, without concern for the policy consequences of your actions. (Caplan, 2008 p.12-20). When people perceive that they have both a stake and impact in the political decision process, they will be more prudent. The small size of Hong Kong acts to preserves its economic freedom.

Another way of understanding this rationality is through the phrase “let’s make a bet”. When someone is asked to “make a bet”, they suddenly stand to lose if their statement or action is incorrect. If this is the case, they will be more likely to conform their opinion and action to those that they believe they will minimize their losses. Similarly, if voters feel there is no reasonable expectation that their vote will affect an outcome of an election, they will vote in a *rationally irrational* manner. That is, they will vote on slogans, charisma, and whatever is socially expedient, instead of by carefully weighing the real effects of policies. If they believe they have a hand in the decision to in some way bear the cost of a bad decision or reap the benefits of a good political choice, they will take time to dispassionately consider the real effects of policy (Caplan, 2008 p.190-194). If voters feel they can change the outcome of an election, they will make wiser decisions. The smaller the electorate, the greater the chance an individual will perceive his vote as consequential, and the more he will feel the need to weigh his options and support the suite of policies he believes will be most conducive to prosperity (Caplan, 2008 p.12-20 & 108-110). Hong Kong’s small size, and history of political activism, free speech, and autonomy make it so, even under pressure, prudent economic policy is adopted as much as it can be.

SEZ are successful insofar as they can utilize the information in prices, and those prices are not abrogated by government interventions. Determining land ownership based on bids, and requiring companies to build their own infrastructure assures market generated knowledge is heeded in development. SEZ have been successful when they are created according to entrepreneurial judgment, only then are they able to fully access the knowledge conveyed in the price system. There cannot truly be a monolithic one size fits all blueprint for the establishment of SEZ, or economic development such as the “Asian Model” (Powell, 2005 p.307).

Businesses wanting to locate in a SEZ should bid on the value of the land, so that proposed SEZ are built where they are most profitable. This process will make sure SEZ are not built detrimentally far from civilization, or in areas not suited for the kind of production and commerce they are meant to contain. Under a competitive land bidding process, the problem of favoritism and rent-seeking is mitigated. Governments setting up SEZ should allow companies to bid for admission into a SEZ, instead of deciding land size and industries without regard to the knowledge in the price system. The government should also avoid costly infrastructure projects, and allow private companies to build the necessary utilities, so that government money is not wasted, in providing extraneous and irrelevant services.

SEZ should be given autonomy over the specifics of their economic policy as a meaningful system of self-governance (in a small region) will tend to produce rational economic policy. The SEZ also must obtain a robust legal promise that the conditions in the SEZ will be maintained, and/or the policies the residents decide will be honored by the host government.

The hundred year involvement of the British, in the instance of Hong Kong, assured that Beijing’s policy toward the coastal city remains stable and certain. Ultimately, Hong Kong entrepreneurs are confident in the long term credibility of the Chinese government’s promise to maintain and honor Hong Kong autonomy. This is a trust that is built up over years, and not something that can simply be declared without adequate surety.

Economist Paul Romer recognizes these problems and points to ways of making such promises more immediately credible. A nation that is host to a SEZ can enter into a monitoring agreement with another nation which will then oversee the SEZ and assure all agreed upon conditions are met-even over the long term. This is not a call for a new form of colonialism, but a realization that SEZ alone don’t have any way to ensure their own continuation over the long term. SEZ can be administered from an outside country, for example a free port in Cuba might be administered by Canada, thus dissuading Havana from reneging on their agreement on the conditions governing that free port. (Romer, 2009 video). Designing more credible promises for entrepreneurs, eliminating a source of uncertainty, mean that economic development will begin sooner in new SEZ.

Adam Smith identified peace, a tolerable administration of justice and low taxation as the best way to encourage entrepreneurship (Boettke p 13, 19 & 21). Not much else is really needed. Under these conditions, entrepreneurs can rely on unabrogated price signals without having to face the additional uncertainty born of erratic government action and usurpations of property rights. Across the globe, governments have taken this theory and tried to recreate these conditions in specific zones. They have experimented with radical departures in policy that would be otherwise politically untenable (Moburg, 2013 p10 & 17). By looking at the successes of SEZ like Shenzhen, and the Hong Kong SAR and contrasting them with failed SEZ, it’s possible to see how Adam Smith’s formula has manifested itself in successful real world policy. With this knowledge, it’s will be possible to increase the success rate of SEZ, and make them more politically desirable as tools of economic prosperity.

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**Appendix A:** SEZ in America

Special Economic Zones are widespread phenomenon, but the idea of designating a small zone for policy experimentation is quintessentially American. Supreme Court Justice Brandeis called the states “laboratories of Democracy”, where innovation could occur and best practice could be disseminated across the country (Greve, 2001 p 1). SEZ are an attempt to do just that! Introducing SEZ in the US would be neither a radical concept nor a foreign idea. In a partisan climate where the slightest pro-market economic reforms seem implausible, allowing policy experimentation in a small zone makes implementation more likely.

Although the US has never experimented with SEZ outright, the federal government has proposed applying special conditions to blighted areas in the hope of spurring economic development. One of the most well-known efforts to do this was pushed by HUD Secretary Jack Kemp in the 90s. His plan on revitalizing urban areas with Enterprise Zones has since given way to two more recent plans. President Barack Obama and Senator Rand Paul have both unveiled SEZ-esq plans to alleviate poverty. The President’s Promise Zones will be marked by “intensive federal partnership” whereby the federal government will invest heavily at the local level to increase education funding and achieve other community goals (The White House). Additionally, these areas will be uniquely and strongly targeted for federal civil service organizations like AmeriCorps, and others. The President’s plan calls for tax credits and tax cuts on hiring and investment activity in designated Promise Zones (The White House).

Senator Paul’s plan for Economic Freedom Zones has the same purpose, and targets similar areas of the country. This plan will see individual and corporate taxes radically reduced and the capital gains tax eliminated (Rand Paul Senate Office). Union regulations will be reduced, prevailing wage laws will be overturned and all public sector pensions will be moved to a defined benefits model. Senator Paul’s plan also implements Milton Friedman’s idea of a school voucher system, where tax dollars travel with children and are credited to the school they attend, be it public or private (Rand Paul Senate Office). Economic Freedom Zones will also be able to grant their own visas to “skilled and entrepreneurial immigrants” if they have a business that employs over 5 American workers or have rehabilitated $25K worth of abandoned property. EPA non-attainment requirements will be suspended in these zones (Rand Paul Senate Office). Although they take different forms, the idea of SEZ in America is a bipartisan idea that can-and should-be explored more deeply by the public.

**Appendix B:** Topics for Further Research

Study historical examples of self-governing zones and their economic performance/policies. Renaissance era city-states and Huguenot settlements in France can be examined.

Investigate if Radical Uncertainty be expressed in a way that would satisfy Neo-Classical understanding/Search Theory?

Critique the economics behind Lyndon Johnson’s “Model Cities” program (part of the “Great Society” reforms).

Explore how the lessons of successful SEZ be adapted to use on a Seastead (Conceptual permanent dwelling on the ocean outside national boarders).