

The benefits of economic freedom

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Economic freedom creates positive social and economic dynamics. In economically free nations, people succeed by creating goods or services that others want to buy. In other words, people get ahead by creating benefits for other people. Where economic freedom does not exist, economies grow slowly, if at all, and people gain by seeking political favors (“rent-seeking”) and limiting the possibilities of others. Where economic freedom does exist, the biggest gains are achieved by people who increase the size of the economic pie for everyone; without economic freedom, the biggest gains are achieved by those who cut a bigger slice of the pie for themselves to the disadvantage of others.

This is a key reason why economic freedom has been shown to promote democracy and other freedoms (Griswold, 2004). The dynamics of a society in which individuals gain by promoting the well-being of other individuals (by efficiently creating goods and services people want) differ dramatically from the dynamics of a society in which, in the absence of economic freedom, rent-seeking and power-hoarding is the path to increased wealth and power. The first dynamic is conducive to a stable, peaceful, civil society marked by freedom; the latter dynamic creates incentives for reducing freedoms.

Since the publication of the first edition of the *Economic Freedom of the World* in 1996 and, more recently, national and regional indexes such as *Economic Freedom of North America*, about 350 scholarly and policy articles using the economic freedom indexes to explore the relationship between economic freedom and other socioeconomic outcomes have been published. In this article, I will focus briefly on the relationship of economic freedom to economic growth and prosperity.¹



Intuitively, one would expect that economic freedom would have a positive impact on economic growth because economic freedom creates a climate that allows individuals and business to allocate their resources to the highest end use. However, the question is ultimately an empirical one. Easton and Walker (1997), in one of the first studies on economic freedom and economic growth, found that changes in economic freedom have a significant impact on the steady-state level of income, even after the level of technology, the level of education of the workforce, and the level of investment are taken into account.

De Haan and Sturm (2000) showed empirically that increases in economic freedom boost economic growth, while reductions in freedom slow growth. Using the economic freedom index published in Gwartney et al. (1996) and per capita GDP data for 80 countries, they found that after accounting for educational level, investment, and population growth, increased economic freedom has a significant impact on economic growth.

Gwartney and Lawson (2004) examined the impact of economic freedom on economic growth but with a specific focus on investment and productivity. They found that economic freedom strongly promotes investment. Nations with an economic freedom of the world (EFW) score below 5 (on a scale from zero to 10, where a higher value indicates a higher level of economic freedom) attracted \$845 in investment per worker and only \$68 per worker in foreign direct investment over the period of 1980 to 2000. Nations with an economic freedom score above 7 attracted \$10,871 in investment per worker, including \$3,117 of foreign direct investment, over the same period of time.

Moreover, investment is more productive in economically free nations. Holding constant factors thought to affect growth and productivity, such as initial per capita GDP, tropical location, coastal location, change in human investment, and public investment, Gwartney and Lawson (2004) found that an increase of one percentage point in the ratio of private investment to GDP leads to increases in the growth rate of per capita GDP by 0.33 percentage points in an economically free country. The same increase in private investment in a less economically free country increases the growth rate of per capita GDP by 0.19 percentage points. In other words, investment in economically free nations (with a EFW score above 7) had a positive impact on growth that was 70% greater than investment in nations with poor levels of economic freedom (having a score below 5).

Using the same regression model, Gwartney and Lawson also calculated the impact of economic freedom on overall growth through both direct and indirect effects. They found that if a nation increased its economic freedom by one unit (on a scale from zero to 10) in the 1980s, it would have seen increased GDP growth of 1.9 percentage points per year over the period of 1980 to 2000. They also found that, because of the high rates of growth associated with economic freedom, over the long term, economic freedom explains over two-thirds of cross-country variation in GDP.

Increases in economic freedom also reduce poverty (Norton and Gwartney, 2008). Specifically, the population-weighted \$1-per-day poverty rate was 29.7% in 2004 for countries with EFW ratings of less than 5, but only 7.7% for countries with EFW ratings between 6 and 7; the \$2-per-day poverty rate declines from 51.5% to 46.2% to 38.9% as one moves from the least to the most free economies. Moreover, a one-unit increase in the EFW rating between 1980 and 1995 was associated with a 5.21 percentage-point reduction in the \$1-per-day poverty rate and a 5.22 percentage-point reduction in the \$2-per-day poverty rate.

Norton and Gwartney also examined the relationship between economic freedom and other measures of well-being. In the mostly unfree economies, 72.6% of the population have access to safe water compared to nearly 100% in the mostly free economies. The life expectancy of people in the mostly free group is over 20 years greater than that of people in mostly unfree economies. Mostly free economies have more than twice as many physicians per 1,000 population than mostly unfree economies. For

every 1,000 births, 64 more babies survive in mostly free economies per year than in mostly unfree countries. For every 1,000 children under the age of five, 109 more children survive in mostly free countries each year than in countries that are mostly unfree.

A large body of peer-reviewed empirical research shows similar results, as well as economic freedom's relationship with other positive outcomes. For a sample of the literature on economic freedom, visit <<http://www.freetheworld.com>>. For a summary of the literature on economic freedom and economic prosperity, see Berggren (2003) and Doucouliagos and Ulubasoglu (2006).

Note

1 This article is largely based on Al Ismaily et al. (2008).

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