

Economic Freedom and Prosperity

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Why do some nations prosper while others stagnate? This has been a central issue of economics since the time of Adam Smith. In many ways, modern growth is primarily about brainpower, entrepreneur-ship, and the discovery of better ways of doing things.

This suggests that economic freedom exerts a strong impact on economic progress. Is this really true? In order to answer this question, a measure of economic freedom is needed.

Beginning in 1986, Michael Walker of the Fraser Institute and Nobel laureate Milton Friedman hosted a series of conferences that focused on the measurement of economic freedom. Several other leading scholars, including Nobel Prize winners Gary Becker and Douglass North, also participated in the series. These conferences led to the publication of *Economic Freedom of the World*, an annual report co-published by a worldwide network of more than 50 institutes.

The 2001 Annual Report has just been released. It provides the most detailed information ever available on cross-country differences in economic freedom. Data on size of government, price stability, openness of trade, quality of legal structure, and numerous other variables are used to develop a summary index of economic freedom. The index measures the ability of citizens of each country to choose for themselves, engage in market activities, and keep what they earn.

In addition to the regular index which rates 123 countries, this year's report also contains a more comprehensive index for 58 countries. The more comprehensive index is divided into seven areas: size of government, legal system, sound money, openness of trade, and regulation of finance, labor, and business. This index both more fully captures the impact of regulation and more readily pinpoints the strengths and weaknesses of each country.

Chart 1 presents the summary ratings (zero to ten scale) and rankings for the 58 countries of the comprehensive index. As was the case for the regular index, Hong Kong and Singapore ranked as the most free. The two city-state economies were followed by the United States, New Zealand, United Kingdom, Ireland and Canada. Chile (tied with Germany for 16th) was the highest ranked Latin

American economy. Zimbabwe, Brazil, Venezuela, Ukraine, and Russia received the lowest ratings.

Chart 1: Comprehensive Index — Summary Ratings

Rank	Country	Rating	Rank	Country	Rating
1	Hong Kong	8.8	30	Bolivia	6.6
2	Singapore	8.3	30	Philippines	6.6
3	USA	8.2	30	South Africa	6.6
4	New Zealand	8.1	30	Thailand	6.6
5	UK	8.0	34	Malaysia	6.5
6	Ireland	7.9	34	Peru	6.5
7	Canada	7.8	36	France	6.4
7	Switzerland	7.8	36	Israel	6.4
9	Australia	7.7	38	Hungary	6.3
9	Luxembourg	7.7	38	Italy	6.3
9	Netherlands	7.7	40	Egypt	6.2
12	Finland	7.4	40	Korea	6.2
12	Iceland	7.4	42	Greece	6.1
14	Denmark	7.2	42	Mexico	6.1
14	Japan	7.2	44	Czech Rep.	5.9
16	Chile	7.1	44	Turkey	5.9
16	Germany	7.1	46	India	5.6
18	Austria	7.0	47	Indonesia	5.5
18	Belgium	7.0	48	Colombia	5.4
18	Norway	7.0	48	Poland	5.4
18	Taiwan	7.0	48	Slovak Rep.	5.4
22	Costa Rica	6.9	51	Ecuador	5.3
22	Spain	6.9	52	Bulgaria	5.2
22	Sweden	6.9	52	China	5.2
25	El Salvador	6.8	52	Zimbabwe	5.2
25	Jordan	6.8	55	Brazil	5.1
25	Mauritius	6.8	56	Venezuela	5.0
25	Portugal	6.8	57	Ukraine	4.5
29	Argentina	6.7	58	Russia	3.7

Source: *Economic Freedom of the World, 2001 Annual Report.*

People achieve higher living standards and more rapid income growth when they live in freer economies. Chart 2 illustrates this point. It shows the relationship between the economic freedom ratings of the 58 countries on the one hand and 1998 per capita GDP and growth during the 1990s on the other. Both the average income levels and growth rates of the freer economies were persistently higher than the comparable figures for the economies that were less free.

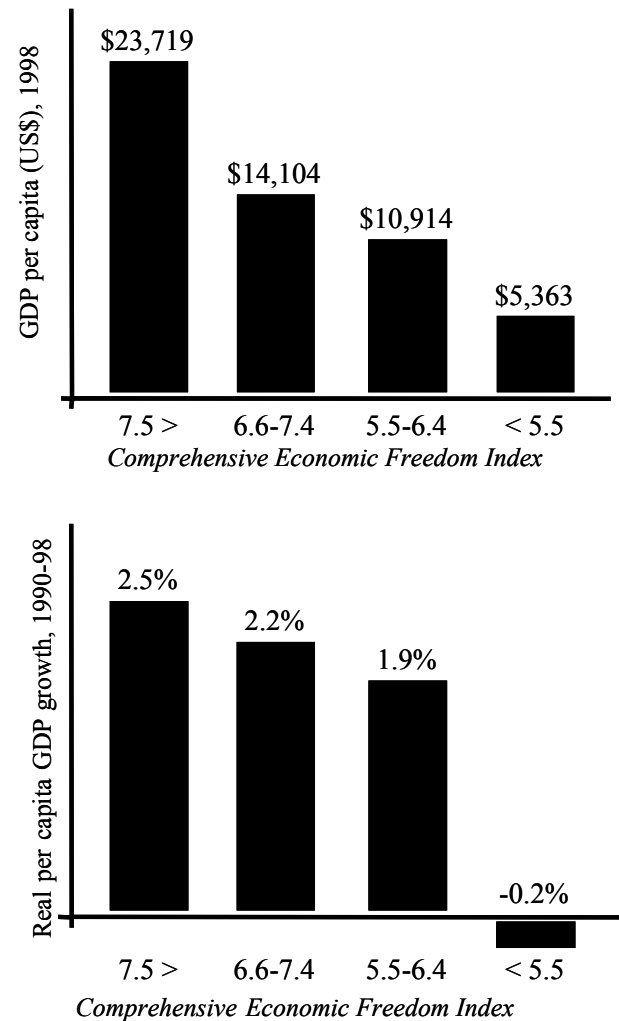
Chart 2 reflects only the simple relationship between economic freedom *at a point in time* and

economic performance. More detailed statistical analysis, however, indicates that both the long-term level of economic freedom and changes over five-year time periods exert a strong and statistically significant impact on economic growth. This is true even after the effects of investment, education, and demographic factors are taken into account.

Other indicators of human welfare also highlight the importance of economic freedom. For example, compared to their less free counterparts, free economies have less poverty and political corruption and they score higher on the United Nations Human Development Index. Perhaps most significantly, people living in countries in the top quintile of the economic freedom scale live more than 20 years longer on average than people in the bottom quintile.

The report also develops an index that provides a measure of trade openness for 91 countries throughout 1980-1998. Economies that have remained open to trade over time have higher incomes and grow more rapidly than those with trade sectors that are more closed. During the last two decades, trade barriers have been reduced and the world economy has become more open. But inadequate legal systems and restrictive business regulations are stifling both economic freedom and progress throughout much of Latin America and among the former socialist countries.

Chart 2 Economic Freedom, Income, and Growth



Source: derived from *Economic Freedom of the World, 2001 Annual Report*.

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