

CHAPTER 2

SOCIETIES THRIVE AS ECONOMIC FREEDOM GROWS

For more than two decades, the *Index of Economic Freedom* has documented the vital role of economic freedom in promoting human progress. People living in nations with higher degrees of economic freedom prosper because their governments rely on systems of free markets to regulate economic activity. At their best, operating without interference, free markets identify and accommodate the needs of society based on the daily decisions of its individual members to buy or sell, to invest or save, reflecting their unique desires and knowledge: No bureaucracies or “experts” required. The collective wisdom that this fundamentally democratic process generates has been shown time and again to promote dynamic growth through efficient resource allocation, value creation, and innovation.

In a diverse world that, depending on where you look, may be either overregulated or underdeveloped or both, economic freedom may be experienced in a variety of settings, from an informal market lacking any form of governance to an advanced economy with carefully stipulated and enforced rules to protect integrity, promote competition, and limit the power within a market of any single participant, including the government itself. The *Index* strives to provide as comprehensive a view of economic freedom as possible with data that illuminate varying aspects of the rule of law, the

size and scope of government, the efficiency of regulations, and the openness of the economy to global commerce.

The imperative to advance economic freedom is stronger than ever. Our world has experienced—*is* experiencing—astounding progress. Millions of the world’s people, however, still live in poverty, and millions in countries both rich and poor are clamoring for change.

Free-market capitalism, built on the principles of economic freedom, can provide that change. It pushes out the old to make way for the new so that real and true progress can take place. It leads to innovation in all realms: better jobs, better goods and services, and better societies.

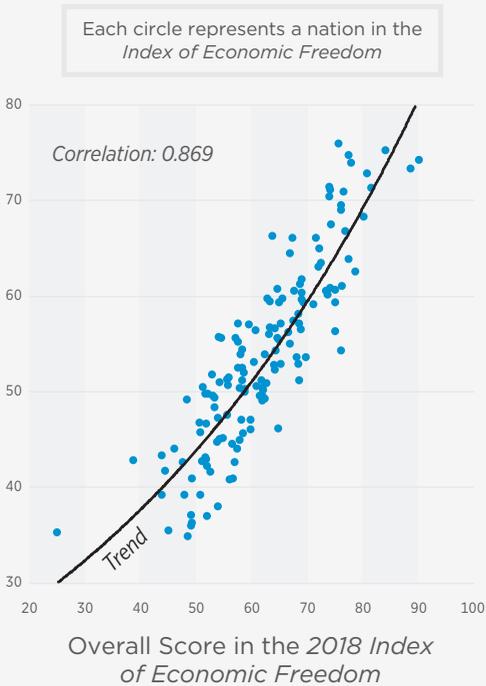
THE GLOBAL ECONOMY: ONLY MODERATELY FREE

Over the last year, the forces of economic freedom around the world have been resilient and even increasing. In fact, economic freedom has taken an upturn in the majority of the economies. Still, the world as a whole remains only moderately free. According to the 2018 *Index*:

- Economic freedom improved worldwide for the sixth year in a row, with the average score up by two-tenths of a point from the previous year.

ECONOMIC FREEDOM AND ENTREPRENEURIAL DYNAMISM

Legatum Prosperity Index's Business Environment Pillar Score



NOTE: Represented are the 146 countries that are in both the 2018 Index of Economic Freedom and the Legatum Prosperity Index 2016.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2018 Index of Economic Freedom* (Washington: The Heritage Foundation, 2018), <http://www.heritage.org/index>, and Legatum Institute Foundation, *The Legatum Prosperity Index 2016*, <http://www.prosperity.com/rankings> (accessed November 21, 2017).

Chart 1 heritage.org

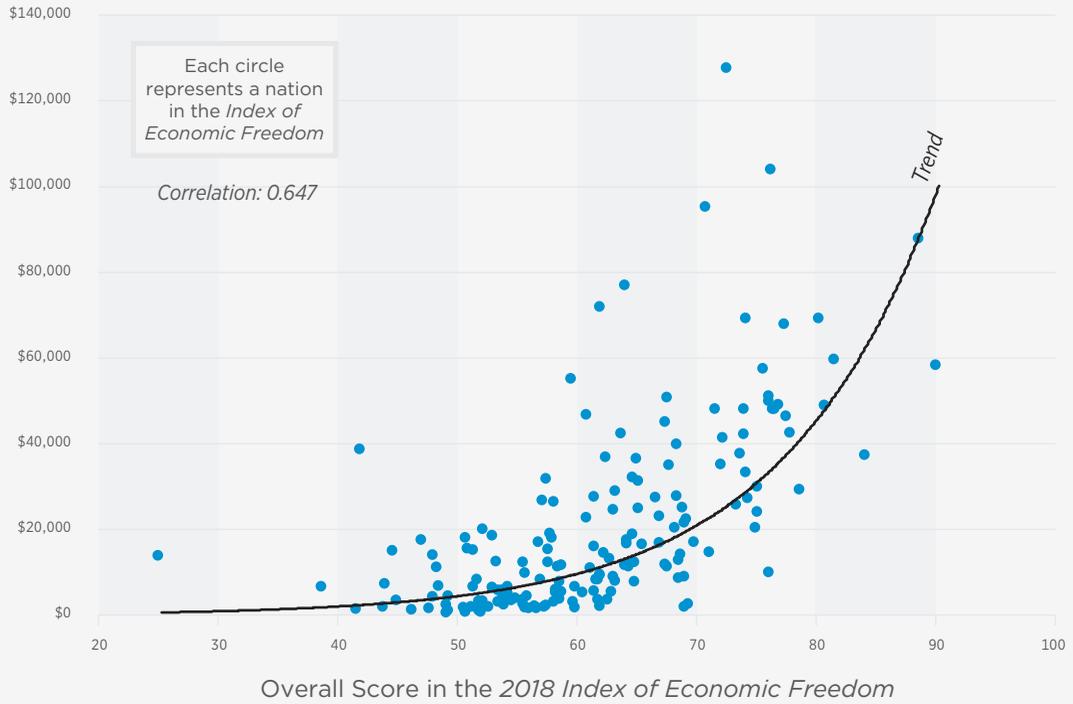
- The global average economic freedom score of 61.1 is the highest ever recorded in the 24-year history of the *Index*. The world average is now more than three points higher than it was in the first edition of the *Index* in 1995.

- Of the 180 economies graded in the 2018 *Index*, the scores of 102 are better, the scores of 75 are worse, and the scores of three are unchanged.
- Six economies have sustained very high economic freedom scores of 80 or more, putting them in the ranks of the economically “free.”
- The next 28 countries have been rated as “mostly free” economies, recording scores between 70 and 80. With scores of 60 to 70, 62 countries have earned scores that place them in the “moderately free” category. A total of 96 economies—53 percent of all nations and territories graded in the 2018 *Index*—provide institutional environments in which individuals and private enterprises benefit from at least a moderate degree of economic freedom in the pursuit of greater economic development and prosperity.
- On the opposite side of the spectrum, nearly half of the countries graded in the *Index*—84 economies—have registered economic freedom scores below 60. Of those, 63 economies are considered “mostly unfree” (scores of 50–60), and 21 are clearly “repressed” (below 50).

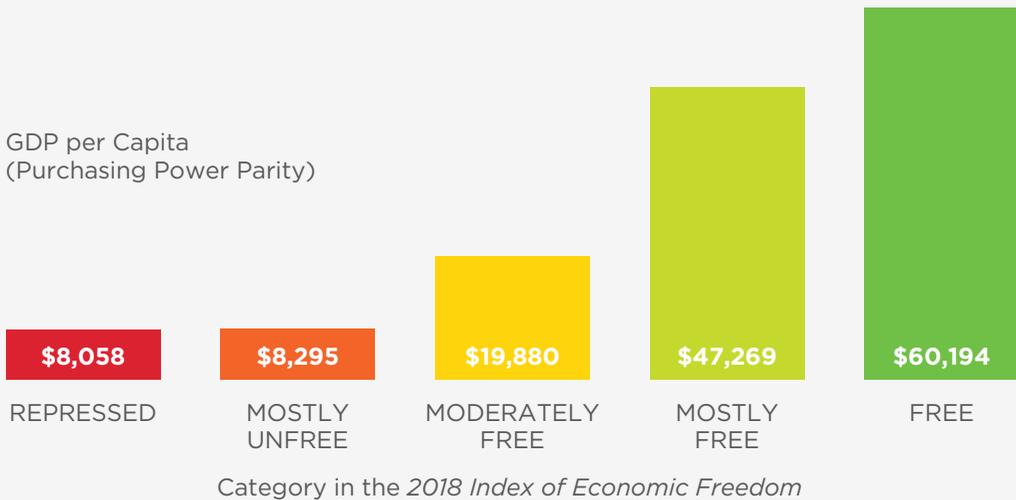
The findings of the 2018 *Index* evince yet again the strongly positive linkages between economic freedom and various dimensions of human and socioeconomic development. The intricate, multidimensional, and nonlinear links highlight why economic freedom is unmatched both in finding solutions to human problems and in advancing overall well-being. No other alternatives that have been tried have come close to free-market capitalism based on economic freedom in terms of providing broader-based prosperity and making a greater number of innovative solutions available to the most people most effectively.

ECONOMIC FREEDOM AND STANDARD OF LIVING

GDP per Capita (Purchasing Power Parity)



GDP per Capita
(Purchasing Power Parity)



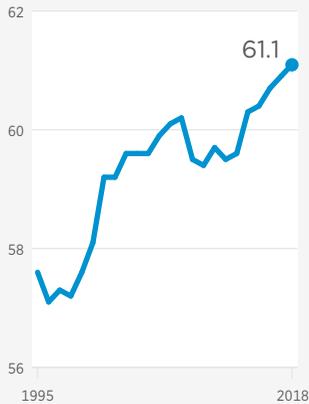
NOTE: Due to data incompatibility, Cuba, Kosovo, and North Korea have been excluded.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2018 Index of Economic Freedom* (Washington: The Heritage Foundation, 2018), <http://www.heritage.org/index>, and International Monetary Fund, World Economic Outlook Database, April 2017, <https://www.imf.org/external/pubs/ft/weo/2017/01/weodata/index.aspx> (accessed November 17, 2017).

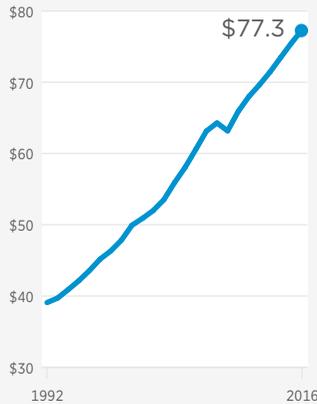
Chart 2 heritage.org

AS ECONOMIC FREEDOM RISES, THE GLOBAL ECONOMY EXPANDS AND POVERTY FALLS

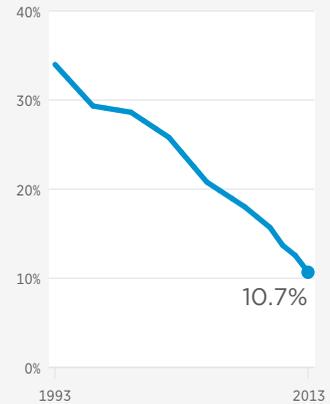
Average Score in the *Index of Economic Freedom*



Global GDP, in Trillions of 2010 U.S. Dollars



Percentage of Global Population in Poverty



SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2018 Index of Economic Freedom* (Washington: The Heritage Foundation, 2018), <http://www.heritage.org/index.org/index>; The World Bank, *World Development Indicators*, <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators> (accessed November 16, 2017); and The World Bank, PovcalNet, <http://iresearch.worldbank.org/PovcalNet/povDuplicateWB.aspx> (accessed November 16, 2017). Some figures have been interpolated.

Chart 3  heritage.org

ECONOMIC FREEDOM: THE VITAL LINK BETWEEN OPPORTUNITY AND PROSPERITY

In general, the overarching objective of economic policies should be to create an environment that provides the best chance of translating opportunity into prosperity.

Today's successful economies are not necessarily geographically large or richly blessed with natural resources. Many economies have managed to expand opportunities for their citizens by enhancing their economic dynamism. The *Index* results have shown that such economic dynamism can be sustained when governments adopt economic policies that empower individuals and firms with more choices, thereby encouraging greater entrepreneurship.

In other words, economic freedom is closely related to openness to entrepreneurial activity. Chart 1 shows the close correspondence

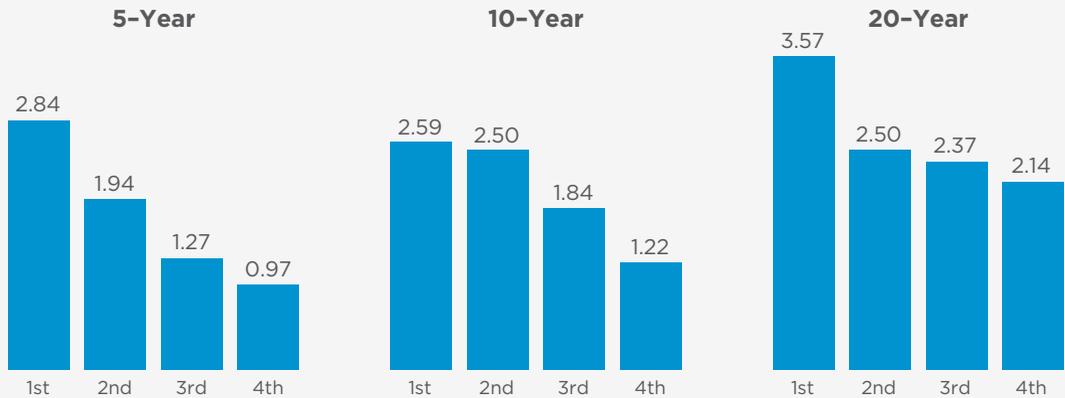
between economic freedom and entrepreneurial opportunity measured by the Business Environment pillar of the Legatum Prosperity *Index*.

Given this relationship, it should be apparent that a government's most effective stimulus activity will not be to increase its own spending or increase layers of regulation, both of which reduce economic freedom. The best results are likely to be achieved instead through policy reforms that improve the incentives that drive entrepreneurial activity, creating more opportunities for greater economic dynamism.

Equally notable is the strong positive relationship between economic freedom and levels of per capita income. For countries achieving scores that reflect even moderate levels of economic freedom (60 or above), the relationship between economic freedom and per capita GDP is highly significant.

INCREASING ECONOMIC FREEDOM AND ECONOMIC GROWTH

Average Annual Growth of GDP per Capita (Purchasing Power Parity)



Increase in Economic Freedom, by Quartile

NOTES: Figures are country averages in which both *Index* scores and data on GDP growth are available over the same time period. Five-year growth rates include 167 countries, 10-year growth rates include 164 countries, and 20-year growth rates include 145 countries.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2018 Index of Economic Freedom* (Washington: The Heritage Foundation, 2018), <http://www.heritage.org/index>, and International Monetary Fund, World Economic Outlook Database, April 2017, <https://www.imf.org/external/pubs/ft/weo/2017/01/weodata/index.aspx> (accessed November 16, 2017).

Chart 4  heritage.org

As indicated in Chart 2, countries moving up the economic freedom scale show increasingly high levels of average income. Economies rated “free” or “mostly free” in the 2018 *Index* enjoy incomes that are over twice the average levels in all other countries and more than five times higher than the incomes of “repressed” economies.

ECONOMIC FREEDOM: ANTIDOTE TO POVERTY

By a great many measures, the past two decades, during which the *Index* has been charting the advance of economic freedom, have been the most prosperous in the history of humankind. Those countries that have adopted some version of free-market capitalism, with economies open to the free flow of goods, services, and capital, have participated in an era of globalization and economic integration that

provided solutions to many of the world’s development problems.

Unquestionably, the free-market system that is rooted in the principles of economic freedom—empowerment of the individual, nondiscrimination, and open competition—has fueled unprecedented economic growth around the world. As Chart 3 illustrates, over the life of the *Index*, as the global economy has moved toward greater economic freedom, world GDP has nearly doubled. This progress has lifted hundreds of millions of people out of poverty and cut the global poverty rate by two-thirds.

By opening the gates of prosperity to ever more people around the world, economic freedom has made the world a profoundly better place. More people are living better lives than ever before. Clearly, this monumental reduction in global poverty is an achievement that

POVERTY INTENSITY

Multidimensional Poverty Index
(higher scores indicate more intense poverty)



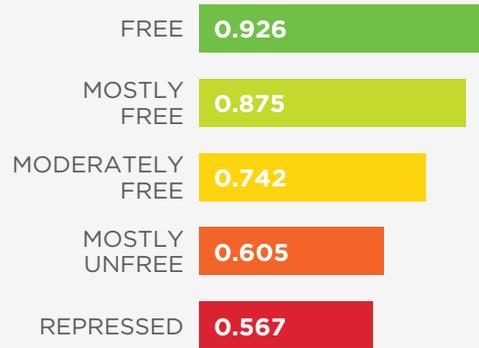
NOTE: Figures are based on the most recent Multidimensional Poverty Index score between 2005 and 2015 for the 96 countries that have both an MPI score for at least one year between 2005 and 2015, and a 2018 *Index of Economic Freedom* score.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2018 Index of Economic Freedom* (Washington: The Heritage Foundation, 2018), <http://www.heritage.org/index>, and U.N. Development Programme, *Human Development Report 2016*, "Multidimensional Poverty Index," <http://hdr.undp.org/en/content/multidimensional-poverty-index-mpi> (accessed November 17, 2017).

Chart 5 heritage.org

ECONOMIC FREEDOM AND HUMAN DEVELOPMENT

Human Development Index Score,
by Index of Economic Freedom
Category



NOTE: Represented are the 176 countries that are in both the 2018 *Index of Economic Freedom* and the *Human Development Index*.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2018 Index of Economic Freedom* (Washington: The Heritage Foundation, 2018), <http://www.heritage.org/index>, and U.N. Human Development Programme, *Human Development Report 2016*, http://hdr.undp.org/sites/default/files/2016_human_development_report.pdf (accessed November 17, 2017).

Chart 6 heritage.org

should inspire celebration of the free-market system, deeper understanding of its dynamics, and greater commitment to its promotion.

The key driver of poverty reduction is dynamic and resilient economic growth that comes with improving economic freedom. Not surprisingly, one of the most important goals of economic policy in almost every country in the world has been to increase the rate of economic growth.

More specifically, as documented in the previous editions of the *Index* and supported by volumes of academic research, vibrant and lasting economic growth results when governments implement policies that enhance economic freedom and empower individuals with

greater choice and more opportunities. In other words, advancing economic freedom is the imperative for dynamic economic expansion and true progress for a greater number of people.

As Chart 4 demonstrates, there is a robust relationship between improvements in economic freedom and levels of economic growth per capita. Whether long-term (20 years), medium-term (10 years), or short-term (five years), the relationship between positive changes in economic freedom and rates of economic growth is consistent. Improvements in economic freedom are a vital determinant of rates of economic expansion that will effectively reduce poverty.

Undeniably, countries moving toward greater economic freedom tend to achieve higher rates

of growth in per capita GDP. In all of the three specific periods examined, the average annual per capita economic growth rates of countries that have grown economic freedom most are at least 50 percent higher than those of countries where freedom has stagnated or slowed.

Greater economic freedom, as one of the most effective means to eliminating poverty, has a major positive impact on poverty levels. Poverty intensity, as measured by the United Nations Development Programme's *Multi-dimensional Poverty Index*, is much lower on average in countries with higher levels of economic freedom. As seen in Chart 5, the intensity of poverty in countries whose economies are considered mostly free or moderately free is only about one-third the level in countries that are rated less free.

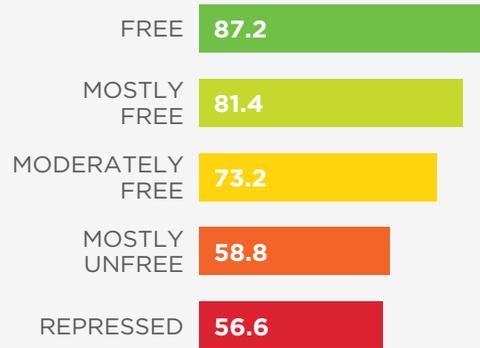
ECONOMIC FREEDOM: PROMOTING BETTER DEVELOPMENT AND DEMOCRATIC PROGRESS

Growing economic freedom is unequivocally about achieving greater overall prosperity that goes beyond materialistic and monetary dimensions of well-being. The societal benefits of economic freedom extend far beyond higher incomes or reductions in poverty. Countries with higher levels of economic freedom enjoy higher levels of overall human development measured by the UNDP's *Human Development Index*, which measures life expectancy, literacy, education, and the standard of living in countries worldwide. As Chart 6 shows, governments that choose policies that increase economic freedom are placing their societies on the pathway to more education opportunities, better health care, and greater standards of living for their citizens.

In recent years, policies and actions concerning the environment have tended to be intrusive and economically distortionary. Governments have pushed programs to tax carbon emissions and increase taxes on gasoline, set up nontransparent and economically harmful exchanges and marketplaces for the buying and

ECONOMIC FREEDOM AND THE ENVIRONMENT

Environmental Performance Index Score, by Index of Economic Freedom Category



NOTE: Represented are the 173 countries that are in both the 2018 *Index of Economic Freedom* and the 2016 *Environmental Performance Index*.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2018 Index of Economic Freedom* (Washington: The Heritage Foundation, 2018), <http://www.heritage.org/index>, and Angel Hsu et al., *2016 Environmental Performance Index* (New Haven, CT: Yale University, 2016), <http://www.epi.yale.edu> (accessed November 17, 2017).

Chart 7  heritage.org

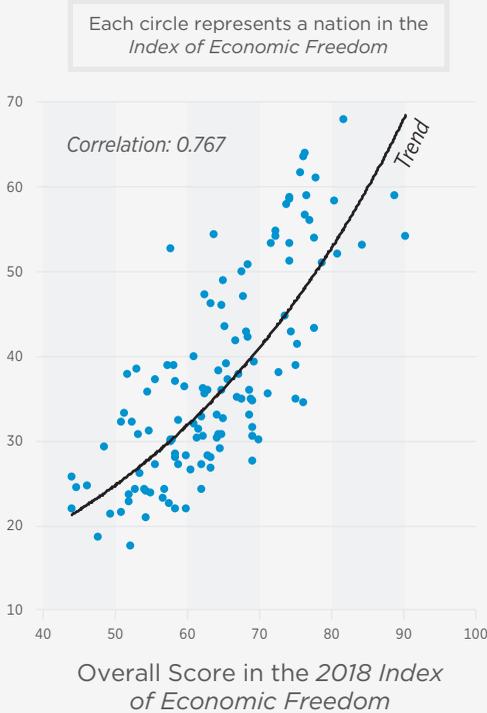
selling of carbon emissions, and created subsidies for so-called clean energy. Such policies not only impose a huge cost on society, but also retard economic growth.

Fortunately, such trade-offs are not required. The same free-market principles that have proven to be the key to economic success can also deliver environmental success. Chart 7 shows the positive relationship between levels of economic freedom and levels of environmental protection as measured in the Yale University *Environmental Performance Index*.

In addition, in countries around the world, economic freedom has been shown to increase countries' capacity for innovation and thus to improve overall environmental performance.

ECONOMIC FREEDOM AND INNOVATION

Global Innovation Index Score



NOTE: Represented are the 126 countries that are in both the 2018 Index of Economic Freedom and the 2017 Global Innovation Index.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2018 Index of Economic Freedom* (Washington: The Heritage Foundation, 2018), <http://www.heritage.org/index>, and Cornell University, INSEAD, and the World Intellectual Property Organization, *The Global Innovation Index 2017*, <https://www.globalinnovationindex.org/gii-2017-report> (accessed November 17, 2017).

Chart 8  heritage.org

The positive link between economic freedom and higher levels of innovation ensures greater economic dynamism in coping with various environmental challenges, and the most remarkable improvements in clean energy use and energy efficiency over the past decades have occurred not as a result of government regulation, but rather because of advances in economic freedom and freer trade. This has

unleashed greater economic opportunity and generated a virtuous cycle of investment, innovation (including in greener technologies), and dynamic economic growth. (See Chart 8.)

Greater economic freedom also can provide more fertile ground for effective democratic governance. Debate over the direction of causality between economic freedom and democracy has become more controversial in recent years due to the multifaceted interaction between the two. Undoubtedly, achieving greater political freedom through well-functioning democracy is a messy and often excruciating process.

However, the positive relationship that exists between economic freedom and democratic governance is undeniable. (See Chart 9.) By empowering people to exercise greater control of their daily lives, economic freedom ultimately nurtures political reform by making it possible for individuals to gain the economic resources necessary to challenge entrenched interests or compete for political power, thereby encouraging the creation of more pluralistic societies.

Pursuit of greater economic freedom is thus an important stepping-stone to democracy. It empowers the poor and builds the middle class. It is a philosophy that encourages entrepreneurship and disperses economic power and decision-making throughout an economy.

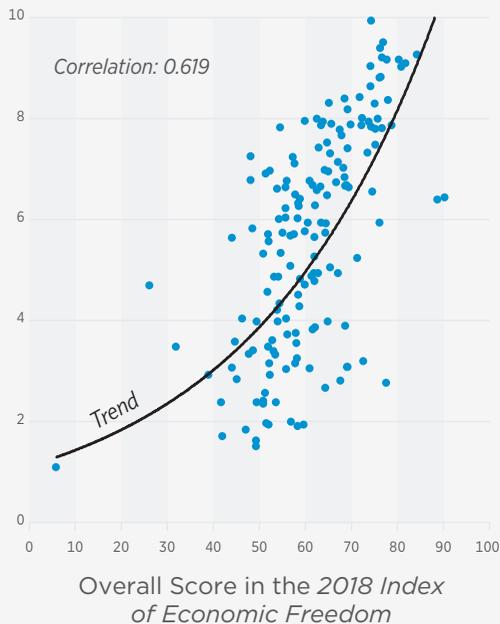
ECONOMIC FREEDOM: ENSURING UPWARD MOBILITY AND GREATER SOCIAL PROGRESS

The massive improvements in global indicators of income and quality of life largely reflect a paradigm shift in the debate about how societies should be structured to achieve the most optimal outcome. Over the past two decades, this debate has largely been won by capitalism. However, fears that the immediate benefits of capitalism are fading have brought to the forefront concerns about economic mobility and economic freedom. At the heart of ensuring upward economic mobility is the task of advancing economic freedom so that dynamic and inclusive growth can occur for *everyone* in a free society.

ECONOMIC FREEDOM AND DEMOCRATIC GOVERNANCE

Democracy Index Score

Each circle represents a nation in the Index of Economic Freedom



NOTE: Represented are the 162 countries that are in both the 2018 Index of Economic Freedom and the Democracy Index 2016.

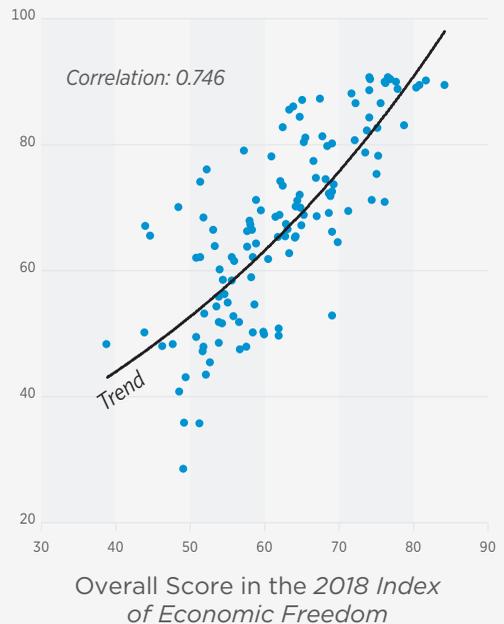
SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2018 Index of Economic Freedom* (Washington: The Heritage Foundation, 2018), <http://www.heritage.org/index>, and The Economist Intelligence Unit, *Democracy Index 2016*, <https://www.eiu.com/topic/democracy-index> (accessed November 17, 2017).

Chart 9 heritage.org

ECONOMIC FREEDOM AND SOCIAL PROGRESS

Social Progress Index Score

Each circle represents a nation in the Index of Economic Freedom



NOTE: Represented are the 127 countries that are in both the 2018 Index of Economic Freedom and the 2017 Social Progress Index.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2018 Index of Economic Freedom* (Washington: The Heritage Foundation, 2018), <http://www.heritage.org/index>, and The Social Progress Imperative, *2017 Social Progress Index*, <https://www.socialprogressindex.com/> (accessed November 20, 2017).

Chart 10 heritage.org

Economic freedom, cultivated by the rule of law, limited government, regulatory efficiency, and open markets, is critical to generating the broader-based economic growth that brings more opportunities for a greater number of people to work, produce, and save. In other words, ensuring greater economic freedom is directly related to preserving and enhancing dynamic upward mobility.

Also notable is that although some naysayers claim that economic and social progress has been limited in recent years as incomes in the developing world have become more unequal and individual economic freedom has expanded, the evidence does not support this contention. Instead, societies based on economic freedom are in fact the ones with the strongest social progress.

As shown in Chart 10, countries that provide an environment conducive to social progress also largely embrace economic freedom.¹ Countries that improve their competitiveness and open their societies to new ideas, products, and innovations have largely achieved the high levels of social progress that their citizens demand. It is not massive redistributions of wealth or government dictates on income level that produce the most positive social outcomes. Instead, mobility and progress require lower barriers to entry, freedom to engage with the world, and less government intrusion.

ECONOMIC FREEDOM MATTERS

The 2018 *Index of Economic Freedom* shows that global economic freedom continues to advance, reaching the highest level in the 24-year history of the *Index*. Behind this record are stories of human progress and the achievements of countries and their citizens—literally billions of people around the world whose lives have measurably improved.

It is no coincidence that the explosion of economic liberty over the past decades has coincided with a massive worldwide reduction in poverty, disease, and hunger. The link between economic freedom and development is clear and strong: People in economically free societies live longer, have better health, are able to be better stewards of the environment, and push forward the frontiers of human achievement in science and technology through greater innovation.

A recurring theme throughout human history has been resilience and revival. The countries gaining ground in the 2018 *Index of Economic Freedom* demonstrate through their achievements that the proven strategies of the free-market system are up to the task of accelerating progress against even the most difficult challenges.

ENDNOTES

1. The Social Progress Index defines social progress as the capacity of a society to meet the basic human needs of its citizens, establish the building blocks that allow citizens and communities to enhance and sustain the quality of their lives, and create the conditions for all individuals to reach their full potential.