

CHAPTER 1

THE *INDEX* OF ECONOMIC FREEDOM AT 25

What makes an economy grow and prosper? Since its inception in 1995, the *Index of Economic Freedom* has provided powerful evidence that economic freedom, measured in the *Index* by factors related to the rule of law, limited government, regulatory efficiency, and open markets, is the answer to that simple yet profoundly consequential question.

Nations with higher degrees of economic freedom thrive because they capitalize more fully on the ability of individuals to innovate and prosper when unfettered by heavy-handed government regulation and taxation. The free-market system encourages the most efficient allocation of resources and generates a dynamic environment that maximizes the choices available for work and consumption. Freedom itself is an important value, and economic freedom is a vital engine for generating the wealth that makes possible the wide range of important economic and social achievements by which we measure the advance of human society.

THE RISE OF GLOBAL ECONOMIC FREEDOM

Over the past 25 years, the global average economic freedom score has increased by 3.2 points, with a significant number of countries joining the ranks of those considered at least “moderately free.” The global average economic freedom score in the 2019 *Index* is 60.8, the third-highest level in the 25-year history of the

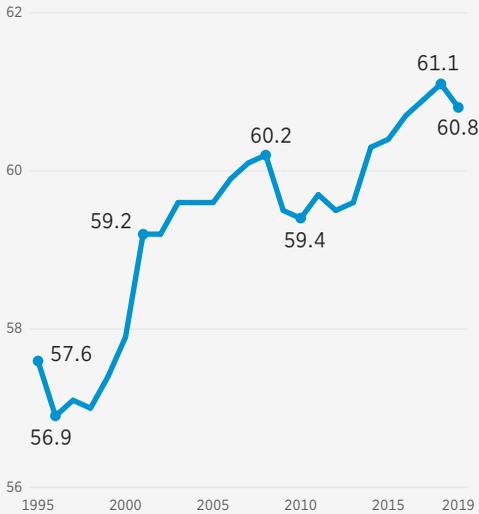
Index. This represents a 5.6 percent increase in global economic freedom from 1995—a notable gain, particularly considering the fact that the fall of the Soviet Union and the rejection of Communism by its European satellites had already been five years in the past when the *Index* was first produced. The growth in economic freedom over the past 25 years has been steady and purposeful rather than revolutionary or convulsive.

The cause of global economic freedom has advanced since 1995, and in its wake has come unprecedented global prosperity. The world economy has grown during the past 25 years from about \$39.2 trillion to well over \$80 trillion, bringing a better standard of living to billions of people. Countries that have opened themselves to the productivity-boosting competition of the global marketplace while adopting or adhering to the principles of limited government, regulatory efficiency, and the rule of law have experienced startling bursts of growth, prosperity, and overall socioeconomic development.

In 2019, the *Index* results show clearly that the principles and lessons of economic freedom have been widely understood, accepted, and implemented in practice by a significant number of countries around the globe. Indeed, there is compelling evidence that economic freedom and economic prosperity go hand in hand. For the relatively few countries that continue to follow a state-centered or socialist path, the negative consequences have been readily apparent

GLOBAL ECONOMIC FREEDOM

Average Score in the *Index of Economic Freedom*



SOURCE: Terry Miller, Anthony B. Kim, and James M. Roberts, *2019 Index of Economic Freedom* (Washington: The Heritage Foundation, 2019), <http://www.heritage.org/index>.

Chart 1  heritage.org

fall into self-inflicted stagnation all too quickly, while long-suffering underdeveloped nations can ascend from poverty to economic dynamism in a matter of years.

UNEVEN PROGRESS IN THE FOUR PILLARS OF ECONOMIC FREEDOM

As the *Index* has documented, the most critical variable in sustaining the economic dynamism and wealth of nations is economic freedom, which is really about dispersing economic power and decision-making throughout an economy and—most important—empowering ordinary people with greater opportunity and more choices. More specifically, lasting prosperity is a result of a persistent commitment to low tax rates, monetary stability, limited government, strong private property rights, openness to global trade and financial flows, and sensible regulation. Together, these factors empower the individual and induce dynamic entrepreneurial activity.

The *Index* findings over the past two-and-a-half decades have validated a number of important policy ramifications, including that:

in their faltering economic performance and a corresponding fall in their *Index* rankings.

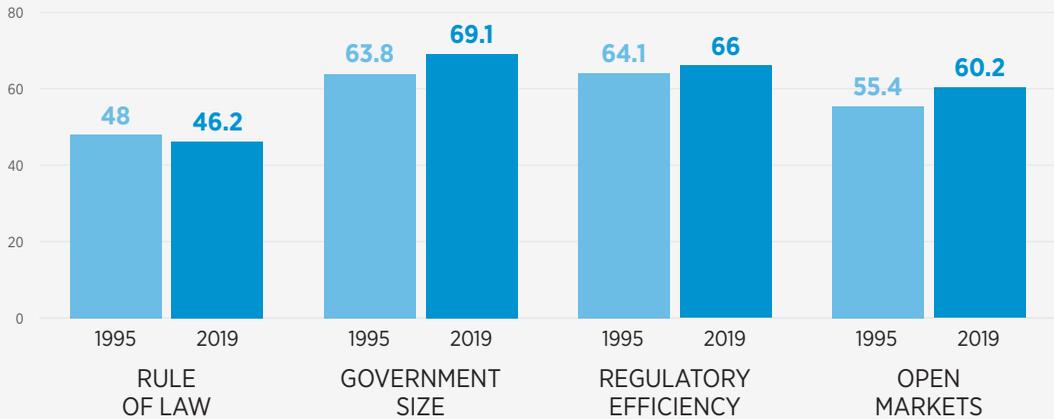
Certainly, there have been setbacks for economic freedom over the past 25 years. Some of them were quite severe as in the aftermaths of the 1997 Asian financial crisis and the 2008 global financial turmoil. Nevertheless, countries that have acknowledged the limits of government and continued their commitment to sustaining economic freedom have reaped tangible rewards of swift economic rebound and renewed dynamism. By contrast, those that have relinquished economic freedom with short-sighted interventionist and populist policies have prolonged the crises and fallen into the trap of economic stagnation and greater uncertainty.

The real examples within the *Index* of the consequences of the rise and fall of economic freedom in countries around the globe demonstrate unmistakably that economic prosperity is not a national birthright. Rich economies can

- Private ownership and the protection of free enterprises by the rule of law encourage effort and initiative far more than do collectivism and socialism.
- Governments that dominate their countries' economies tend to impoverish their citizens through economic stagnation.
- Competition, facilitated by overall regulatory efficiency, promotes greater productivity and a more efficient allocation of resources than does central planning.
- Countries that have adopted and practiced open-market policies in the areas of trade, investment, and banking do better than those that are protectionist or that shun economic linkages with others.

FOUR PILLARS OF ECONOMIC FREEDOM

Changes from 1995 to 2019



SOURCE: Terry Miller, Anthony B. Kim, and James M. Roberts, *2019 Index of Economic Freedom* (Washington: The Heritage Foundation, 2019), <http://www.heritage.org/index>.

Chart 2  heritage.org

Implementing policies that address these four interwoven aspects effectively creates an entrepreneurial environment that is conducive to practical solutions to a wide range of economic and social challenges that are faced by most of the world's societies.

The free-market system that is rooted in economic freedom has fueled unprecedented economic growth and development around the world. However, advances in economic freedom have not occurred evenly across all of the factors measured in the *Index*. Chart 2 shows the changes in average scores over the life of the *Index* for the four pillars of economic freedom.

The growth in overall economic freedom has been driven primarily by advances in policies related to limited government and open markets and to a lesser extent by gains in regulatory efficiency. Since 1995, countries interested in improving their economic performance—and their *Index* rankings as well—have engaged in a sort of competition to adopt lower tax rates, eliminate burdensome regulations, tame inflation, advance free trade, and open their markets for greater investment.

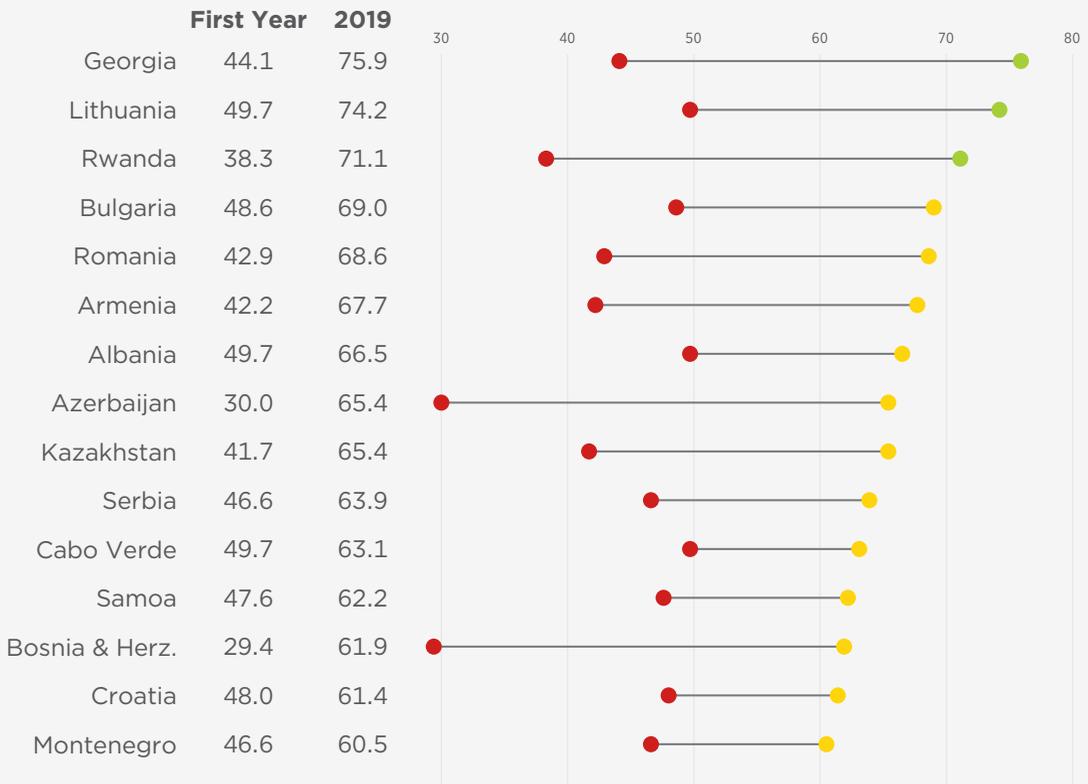
On the other hand, the absence of progress in advancing the rule of law is alarming. A majority of the world's countries score below 50 on the three factors related to this critical institutional aspect of economic freedom, with significant shortfalls apparent in governments' commitments to enhancing property rights, judicial effectiveness, and government integrity.

The rule of law, especially for developing countries, continues to be the pillar of economic freedom that is most important in laying the foundations for economic growth, and in advanced economies, deviations from the rule of law may be the first signs of serious problems that will lead to economic decline.

There is plenty of evidence that rule of law is a critical factor in empowering individuals, ending discrimination, and enhancing competition. In the never-ending struggle to improve the human condition and achieve greater prosperity, the *Index* has shown over the past 25 years that policies that promote the rule of law may well deserve a claim of precedence over other desirable objectives.

COUNTRIES MAKING HUGE STRIDES IN ECONOMIC FREEDOM

Overall Scores in the *Index of Economic Freedom*



SOURCE: Terry Miller, Anthony B. Kim, and James M. Roberts, *2019 Index of Economic Freedom* (Washington: The Heritage Foundation, 2019), <http://www.heritage.org/index>.

Chart 3  heritage.org

OUTPERFORMERS AND UNDERPERFORMERS

Globally, 132 countries have improved their economic freedom scores relative to the first year in which they were rated in the *Index*, while 47 countries have recorded score declines. More notably, 15 developing countries across the globe that were rated as “repressed” in the first year they were graded in the *Index* have successfully leaped forward into the ranks of the “moderately free” or “mostly free.” This is quite a geographically and economically diverse group, encompassing African countries, Eastern European countries, and members of the former Soviet Union.

It is also notable that the Baltic States have tried to follow the Hong Kong and Singapore example as small nations that open themselves to capital and competition, and they have largely prospered because of it. Estonia, Latvia, and Lithuania, all of which have become “mostly free” economies, have reformed their economies, shrunk the size of their governments, opened their markets, and let the talents of their people emerge.

On the other end of the scale, three countries—Bolivia, Ecuador, and Venezuela—have dropped into the ranks of the “repressed” over the past 25 years. These economies were rated more highly in the first years they were graded

in the *Index* but since then have steadily lost economic freedom.

The BRICS economies (Brazil, Russia, India, China, and South Africa) have shown little or no progress in economic freedom. All of them are economically “mostly unfree.” South Africa’s score has actually declined, causing the country to drop out of the status of “moderately free” in the 2019 *Index* for the first time.

Despite the global progress since 1995, the number of people living in economically “unfree” countries remains very high: 4.5 billion, or about 65 percent of the world’s population. More than half of these people live in just two countries: China and India. Even in those countries, however, significant gains in economic freedom over the years (6.4 points for China and 10.1 points for India) have helped hundreds of millions of people to escape from poverty.

THE *INDEX* BEYOND 25: TIME TO STAY ON COURSE

It is no happenstance that the increase of economic liberty over the past 25 years has coincided with a massive reduction in worldwide poverty, disease, and hunger. The link between economic freedom and development is unequivocal: People in economically free societies live longer. They have better health. They

are able to be better stewards of the environment, and they push forward the frontiers of human achievement in science and technology through greater innovation.

A recurring theme of human history has been resilience and revival. As the *Index* has shown over the past 25 years, economic freedom underpinned by free-market capitalism has enabled countries to grow, develop, and prosper. No other systems that have been tried have come close in terms of providing broad-based prosperity.

Perhaps the most critical lesson of the 25 years of *Index* history is that the fundamental superiority and value of economic liberty must be retaught to each new generation of political leaders, either by their peers who have lived in less free systems and less free times or by their own citizens, who understand instinctively that when individuals are allowed to decide for themselves how best to pursue their dreams and aspirations, their collective achievements can add up to a better society for all.

It is too soon to know how the coming years will play out. Nonetheless, if the past 25 years are a guide, it is safe to predict that countries that find the political will to advance economic freedom will see their citizens prosper greatly in the years ahead.