

CHAPTER 4

THE POWER OF ECONOMIC FREEDOM

The *Index of Economic Freedom* 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 need to advance economic freedom is stronger than ever. Our world has experienced—is experiencing—astounding progress, yet many in countries both rich and poor are still clamoring for change. Indeed, a recurring theme of human history has been resilience and revival. History has demonstrated that free-market capitalism, built on the principles of economic freedom, can be relied upon to 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.

ECONOMIC FREEDOM: TRANSFORMING 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. In general, the overarching objective of economic policies must be to create an environment that provides the best chance for translating opportunity into prosperity.

The *Index* results have shown that sustaining such economic dynamism is achievable when governments adopt economic policies that empower individuals and firms with more choices, thereby encouraging greater entrepreneurship.

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 Institute's *Prosperity Index*.

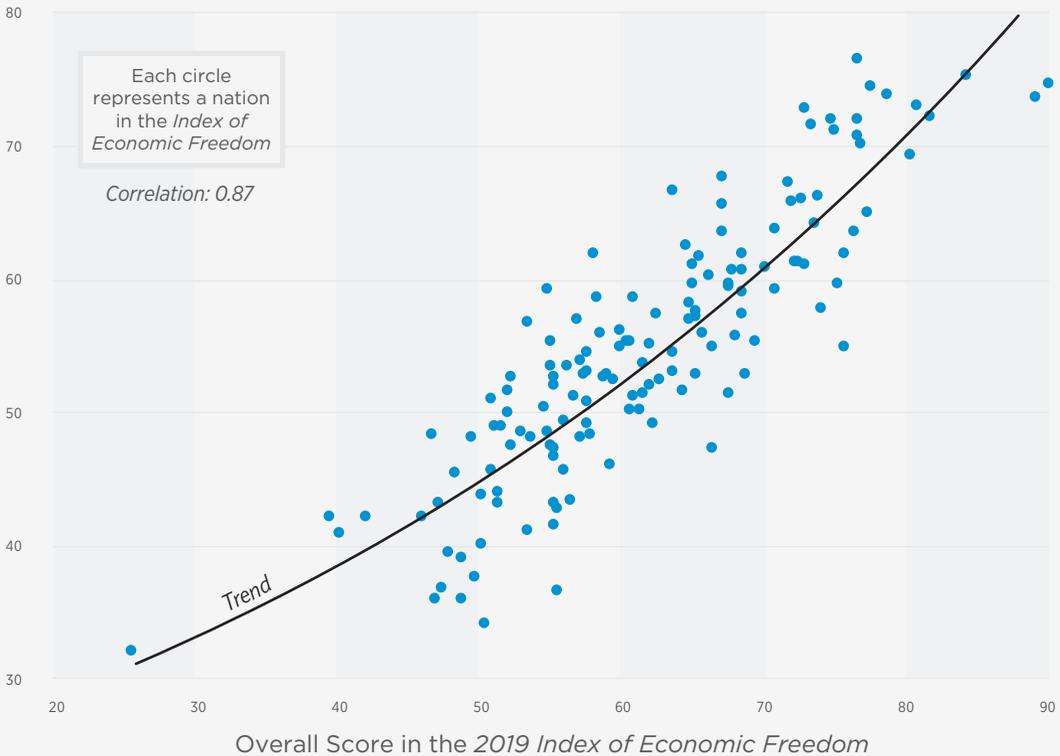
Given this relationship, it should be apparent that a government's most effective stimulus activity will not be to increase its own spending or increase layers of regulation, both of which reduce economic freedom. The best results are likely to be achieved instead through policy reforms that improve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

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 2019

ECONOMIC FREEDOM AND ENTREPRENEURIAL DYNAMISM

Legatum Prosperity Index's Business Environment Pillar Score



NOTE: Represented are the 146 countries that are in both the 2019 *Index of Economic Freedom* and the *Legatum Prosperity Index 2017*.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2019 Index of Economic Freedom* (Washington: The Heritage Foundation, 2019), <http://www.heritage.org/index>, and Legatum Institute Foundation, *The Legatum Prosperity Index 2017*, 2017, <http://www.prosperity.com/rankings> (accessed August 20, 2018).

Chart 1 heritage.org

Index enjoy incomes that are over twice the average levels in all other countries and more than six times higher than the average levels in “repressed” economies.

ECONOMIC FREEDOM: THE PROVEN ANTIDOTE TO POVERTY

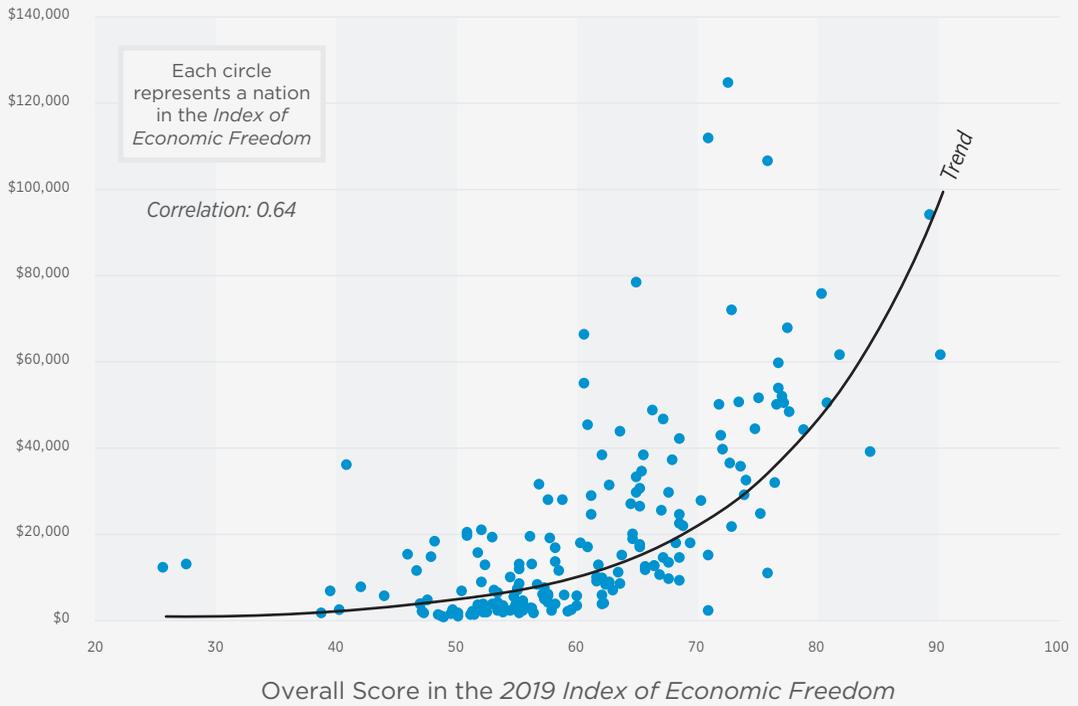
By a great many measures, the past two-and-a-half decades during which the *Index* has been charting the advance of economic freedom have been the most prosperous period in the history of humankind. Countries that have adopted some version of free-market capitalism,

with economies that are open to the free flow of goods, services, and capital, have participated in an era of globalization and economic integration that has provided solutions to many development problems throughout the world.

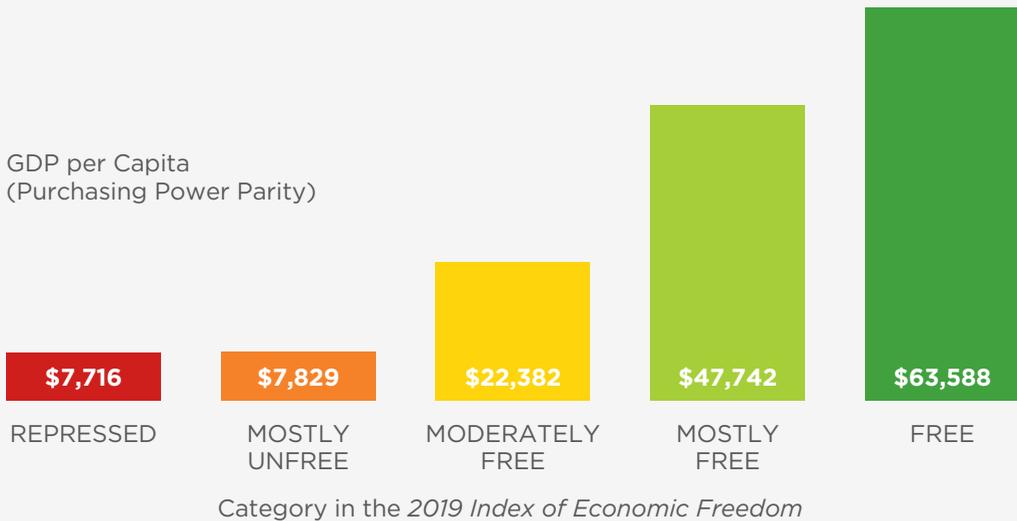
Unquestionably, the free-market system that is rooted in the principles of economic freedom—empowerment of the individual, nondiscrimination, and open competition—has fueled unprecedented economic growth. As Chart 3 illustrates, over the life of the *Index*, as the global economy has moved toward greater economic freedom, the world economy

ECONOMIC FREEDOM AND STANDARD OF LIVING

GDP per Capita (Purchasing Power Parity)



GDP per Capita (Purchasing Power Parity)



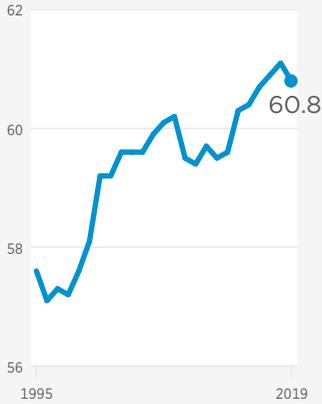
NOTE: Figures do not include North Korea.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2019 Index of Economic Freedom* (Washington: The Heritage Foundation, 2019), <http://www.heritage.org/index>, and International Monetary Fund, World Economic Outlook Database, April 2018, <http://www.imf.org/external/pubs/ft/weo/2018/01/weodata/weoselgr.aspx> (accessed December 4, 2018).

Chart 2 heritage.org

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

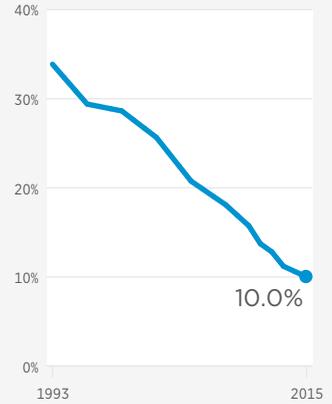
Average Score in the *Index of Economic Freedom*



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



Percentage of Global Population in Poverty

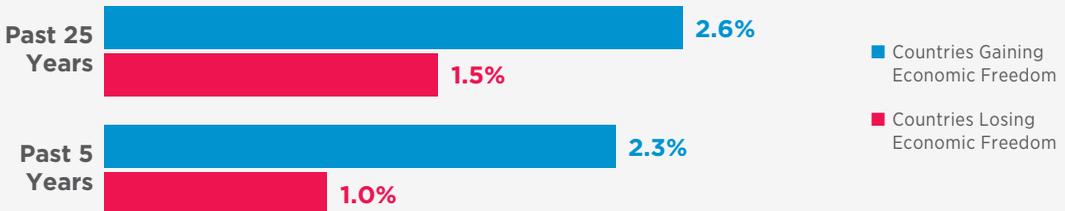


SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2019 Index of Economic Freedom* (Washington: The Heritage Foundation, 2019), <http://www.heritage.org/index.org/index>; The World Bank, *World Development Indicators*, <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators> (accessed December 4, 2018); and The World Bank, PovcalNet, <http://iresearch.worldbank.org/PovcalNet/povDuplicateWB.aspx> (accessed December 4, 2018). Some figures have been interpolated.

Chart 3 heritage.org

INCREASING ECONOMIC FREEDOM AND ECONOMIC GROWTH

Average Annual Growth of GDP per Capita (based on constant local currency)



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 171 countries, and 25-year growth rates include 92 countries.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2019 Index of Economic Freedom* (Washington: The Heritage Foundation, 2019), <http://www.heritage.org/index>, and World Bank, *World Development Indicators*, "GDP per Capita Growth (Annual %)," <https://data.worldbank.org/indicator/NY.GDP.PCAP.KD.ZG> (accessed December 7, 2018).

Chart 4 heritage.org

has doubled in size. This progress has lifted hundreds of millions of people out of poverty, and the global poverty rate has declined by two-thirds.

Opening the gates of prosperity to ever more people around the world, economic freedom has made our globe a profoundly better place. More people are living better lives than ever before. Clearly, this monumental reduction in global poverty is an achievement that 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. Advancing economic freedom is the imperative for dynamic economic expansion and true progress, no matter what a country's current level of development may be.

As Chart 4 demonstrates, there is a robust relationship between improvements in economic freedom and levels of economic growth per capita. Whether long-term (25 years) or short-term (five years), the relationship between changes that advance economic freedom and rates of economic growth is consistently positive. Improvements in economic freedom are a vital ingredient in the achievement of rates of economic expansion that are high enough to reduce poverty effectively.

Undeniably, countries moving toward greater economic freedom tend to achieve higher rates of growth in per capita GDP. Throughout the history of the *Index*, the per capita economic growth rates of countries

POVERTY INTENSITY

Multidimensional Poverty Index
(higher scores indicate more intense poverty)



NOTE: Figures are based on the most recent Multidimensional Poverty Index score between 2006 and 2017 for the 98 countries that have both an MPI score for at least one year between 2006 and 2017, and a 2019 *Index of Economic Freedom* score.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2019 Index of Economic Freedom* (Washington: The Heritage Foundation, 2019), <http://www.heritage.org/index>, and U.N. Development Programme, *Human Development Report 2018*, "Multidimensional Poverty Index," <http://hdr.undp.org/en/content/multidimensional-poverty-index-mpi> (December 5, 2018).

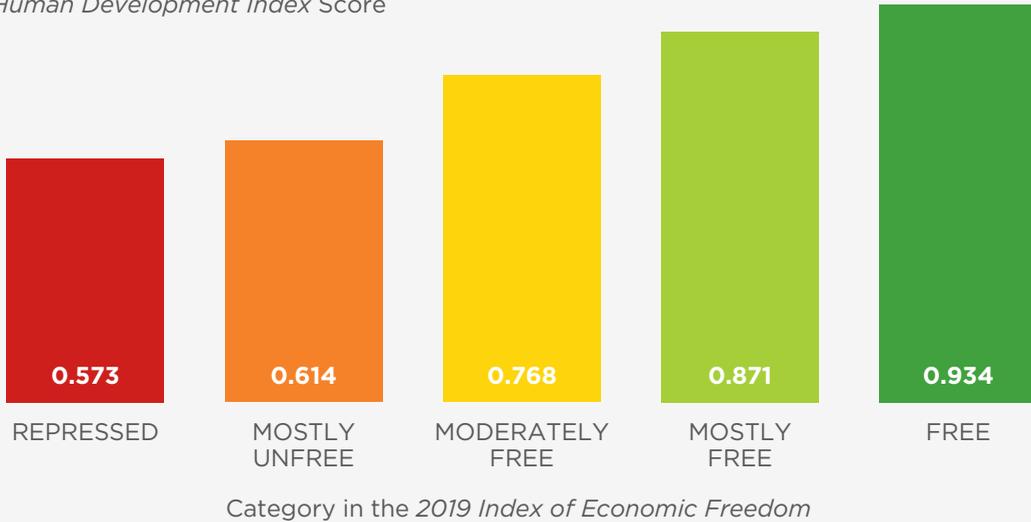
Chart 5  heritage.org

that have grown in economic freedom the most are on average at least 50 percent higher than those of countries where freedom has stagnated or slowed.

Greater economic freedom, while one of the most effective means of eliminating poverty, also has a major positive impact on the standard of living of those who remain poor. Poverty intensity, as measured by the United Nations Development Programme's *Multidimensional 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 developing countries whose economies are considered mostly free or moderately free is only about one-third the level prevailing in countries that are rated less free.

ECONOMIC FREEDOM AND HUMAN DEVELOPMENT

Human Development Index Score



NOTE: Represented are the 176 countries that are in both the 2019 Index of Economic Freedom and the Human Development Index.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2019 Index of Economic Freedom* (Washington: The Heritage Foundation, 2019), <http://www.heritage.org/index>, and U.N. Human Development Programme, *Human Development Report 2018*, http://hdr.undp.org/sites/default/files/2018_human_development_statistical_update.pdf (accessed December 5, 2018).

Chart 6  heritage.org

ECONOMIC FREEDOM: THE KEY TO HUMAN DEVELOPMENT AND DEMOCRATIC PROGRESS

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 as measured by the United Nations Development Programme'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 path to more education opportunities, better health care, and higher standards of living for their citizens.

In recent years, policies and actions concerning the environment have tended to be

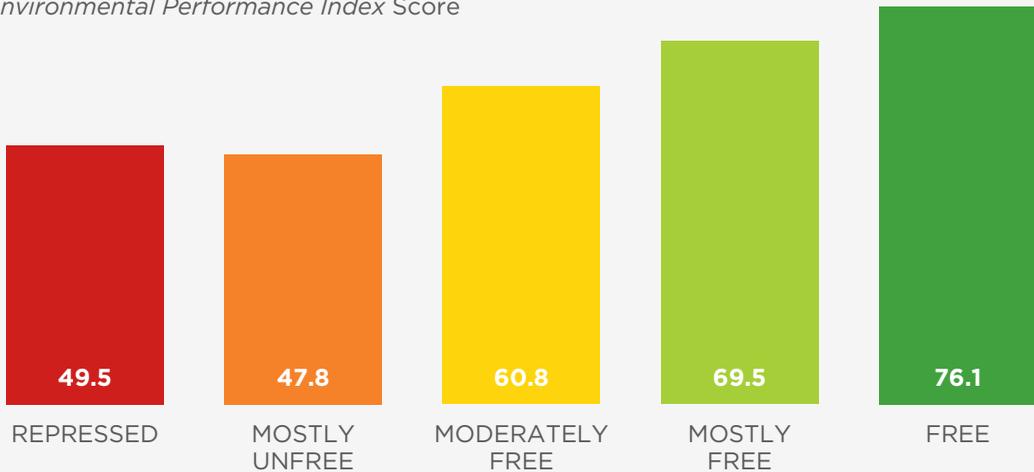
intrusive and economically distortionary. Governments have pushed programs to tax carbon emissions and increase taxes on gasoline, have set up nontransparent and economically harmful exchanges and marketplaces for the buying and selling of carbon emissions, and have created subsidies for so-called clean 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 Yale University's *Environmental Performance Index*.

In addition, in countries around the world, economic freedom has been shown to increase

ECONOMIC FREEDOM AND THE ENVIRONMENT

Environmental Performance Index Score



Category in the 2019 Index of Economic Freedom

NOTE: Represented are the 176 countries that are in both the 2019 Index of Economic Freedom and the 2018 Environmental Performance Index.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2019 Index of Economic Freedom* (Washington: The Heritage Foundation, 2019), <http://www.heritage.org/index>, and Yale University, *2018 Environmental Performance Index* (New Haven, CT: Yale University, 2018), <https://epi.envirocenter.yale.edu> (accessed December 5, 2018).

Chart 7  heritage.org

countries' capacity for innovation and thus to improve overall environmental performance as well. The positive link between economic freedom and higher levels of innovation ensures greater economic dynamism in coping with various environmental challenges. 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.

Greater economic freedom can also 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 because of 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 8.) 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 needed to challenge entrenched interests or compete for political power.

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 AND DEMOCRATIC GOVERNANCE

Democracy Index Score



NOTE: Represented are the 162 countries that are in both the 2019 Index of Economic Freedom and the Democracy Index 2017.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2019 Index of Economic Freedom* (Washington: The Heritage Foundation, 2019), <http://www.heritage.org/index>, and The Economist Intelligence Unit, *Democracy Index 2017*, <https://www.eiu.com/topic/democracy-index> (accessed December 5, 2018).

Chart 8  heritage.org

ECONOMIC FREEDOM: SAFEGUARDING 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 over how societies should be structured to achieve the most optimal outcome. In recent decades, this debate has largely been won by capitalism. Nonetheless, fears that the immediate benefits of capitalism are fading have brought to the forefront concerns about economic mobility and inequality. Even while acknowledging the positive impact of economic freedom in raising

GDP growth, opponents of free-market capitalism continue to suggest that reducing the size and scope of government leads to harmful social consequences and can increase the gap between the rich and poor.

The data, however, tell a different story.

As shown in Chart 9, countries that provide the most conducive environments for social progress also largely embrace economic freedom. 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. Also notable is that nations with higher levels of economic freedom

ECONOMIC FREEDOM AND SOCIAL PROGRESS

Social Progress Index Score



NOTE: Represented are the 145 countries that are in both the 2019 Index of Economic Freedom and the 2018 Social Progress Index.

SOURCES: Terry Miller, Anthony B. Kim, and James M. Roberts, *2019 Index of Economic Freedom* (Washington: The Heritage Foundation, 2019), <http://www.heritage.org/index>, and The Social Progress Imperative, *2018 Social Progress Index*, <https://www.socialprogressindex.com/> (December 5, 2018).

Chart 9  heritage.org

have a tendency toward a more even distribution of income.

It is not massive redistributions of wealth or government dictates on wages or prices 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: REGIONAL VARIATIONS (REGIONAL AVERAGE)

Regional Ranking	The Americas (59.6)	Asia-Pacific (60.6)	Europe (68.6)	Middle East/ North Africa (62.4)	Sub-Saharan Africa (54.2)
1	Canada	Hong Kong	Switzerland	United Arab Emirates	Mauritius
2	United States	Singapore	Ireland	Israel	Rwanda
3	Chile	New Zealand	United Kingdom	Qatar	Botswana
4	Saint Lucia	Australia	Iceland	Jordan	Cabo Verde
5	Jamaica	Taiwan	Netherlands	Bahrain	Côte d'Ivoire
6	Uruguay	Malaysia	Denmark	Morocco	Seychelles
7	Peru	South Korea	Estonia	Oman	Tanzania
8	Colombia	Japan	Georgia	Kuwait	Uganda
9	Panama	Macau	Luxembourg	Saudi Arabia	Burkina Faso
10	St. Vincent & Grenadines	Thailand	Sweden	Tunisia	Namibia
11	Costa Rica	Indonesia	Finland	Egypt	South Africa
12	Mexico	Kazakhstan	Lithuania	Lebanon	Mali
13	Barbados	Azerbaijan	Czech Republic	Iran	Ghana
14	Dominica	Brunei	Germany	Algeria	Nigeria
15	The Bahamas	Philippines	Norway	Iraq	Madagascar
16	Guatemala	Bhutan	Austria	Libya	Senegal
17	El Salvador	Kyrgyz Republic	Macedonia	Syria	Gabon
18	Paraguay	Fiji	Latvia	Yemen	Mauritania
19	Dominican Republic	Samoa	Bulgaria		Guinea
20	Honduras	China	Malta		Comoros
21	Nicaragua	Papua New Guinea	Romania		Benin
22	Trinidad and Tobago	Cambodia	Cyprus		Kenya
23	Guyana	Tonga	Poland		Eswatini
24	Belize	Laos	Armenia		São Tomé and Príncipe
25	Haiti	Sri Lanka	Belgium		Guinea-Bissau
26	Argentina	Vanuatu	Kosovo		Ethiopia
27	Brazil	Bangladesh	Albania		Zambia
28	Suriname	Tajikistan	Spain		Lesotho
29	Ecuador	Mongolia	Slovenia		Cameroon
30	Bolivia	Vietnam	Portugal		The Gambia
31	Cuba	India	Hungary		Niger
32	Venezuela	Pakistan	Slovakia		Malawi
33		Solomon Islands	Turkey		Angola
34		Nepal	Serbia		Dem. Rep. Congo
35		Burma	France		Togo
36		Uzbekistan	Italy		Chad
37		Maldives	Bosnia and Herzegovina		Liberia
38		Micronesia	Croatia		Central African Republic
39		Afghanistan	Montenegro		Burundi
40		Turkmenistan	Moldova		Mozambique
41		Kiribati	Russia		Sudan
42		Timor-Leste	Belarus		Sierra Leone
43		North Korea	Greece		Djibouti
44			Ukraine		Equatorial Guinea
45			Liechtenstein		Zimbabwe
46					Rep. Congo
47					Eritrea
48					Somalia

Economic Freedom Scores

- 80–100 Free
- 70–79.9 Mostly Free
- 60–69.9 Moderately Free
- 50–59.9 Mostly Unfree
- 0–49.9 Repressed
- Not Graded