

Executive Summary

Economic Freedom of the World

The index published in *Economic Freedom of the World* measures the degree to which the policies and institutions of countries are supportive of economic freedom. The cornerstones of economic freedom are personal choice, voluntary exchange, freedom to compete, and security of privately owned property. Thirty-eight components and sub-components are used to construct a summary index and to measure the degree of economic freedom in five areas: (1) size of government; (2) legal structure and protection of property rights; (3) access to sound money; (4) international exchange; and (5) regulation.

Economic freedom has grown considerably in recent decades

- ◆ The chain-linked summary index (exhibit 1.4) permits comparison over time. The average economic freedom score rose from 5.17 (out of 10) in 1985 to 6.4 in the most recent year for which data are available. Of the 109 nations with scores in 1985 and in the most recent index, 96 recorded improvement in their economic freedom score, seven saw a decline, and six registered changes of under 0.1 points.
- ◆ Among those nations that have made substantial gains in economic freedom since 1985 are Bolivia, Brazil, El Salvador, Ghana, Iceland, Jamaica, Nicaragua, Peru, Poland, Tanzania, Uganda, and Zambia, though some of these began at very low levels or have experienced ups and downs over the period. Among those nations that have registered significant losses in economic freedom since 1985 are Myanmar, Venezuela, and Zimbabwe.
- ◆ In this year's index (exhibit 1.2), Hong Kong retains the highest rating for economic freedom, 8.7 of 10, closely followed by Singapore at 8.5. New Zealand, Switzerland, and the United States tied for third with ratings of 8.2. The United Kingdom, Canada, and Ireland ranked 6th, 7th, and 8th, respectively. Australia, Estonia, Luxembourg, and the United Arab Emirates tied for 9th. The rankings of other large economies are Germany, 19; Japan, 30; France, 38; Italy, 54; Mexico, 59; India, 66; China, 86; Brazil, 88; and Russia, 115.
- ◆ Most of the lowest-ranking nations are African, Latin American, or former communist states. Botswana's ranking of 30 is the best among continental sub-Saharan African nations. Chile and Costa Rica, tied at 20, have the best record in Latin America. The bottom nations were Burundi, Guinea-Bissau, the Democratic Republic of Congo, Venezuela, Zimbabwe, and Myanmar. However, a number of other nations for which data are not available, such as North Korea and Cuba, may have even less economic freedom.

Nations that are economically free out-perform non-free nations in indicators of well-being

- ◆ Nations in the top quintile in economic freedom have an average per-capita GDP of US\$25,062, compared to US\$2,409 for those nations in the bottom quintile. (Exhibit 1.5)
- ◆ The top quintile has an average per-capita economic growth rate of 2.5%, compared to 0.6% for the bottom quintile. (Exhibit 1.6)
- ◆ Unemployment in the top quintile averages 5.2%, compared to 13.0% in the bottom quintile. (Exhibit 1.8)

- ◆ Life expectancy is 77.7 years in the top quintile compared to 52.5 years in the bottom quintile. (Exhibit 1.9)
- ◆ In nations of the top quintile, the average income of the poorest 10% of the population is US\$6,451, compared to \$1,185 for those in the bottom quintile. (Exhibit 1.11)
- ◆ In nations of the top quintile, only 0.1% of children are in the labor force, compared to 22.6% in the least economically free nations. (Exhibit 1.15)
- ◆ Nations in the top quintile of economic freedom, have an average score of 1.7 for political rights on a scale of 1 to 7, where 1 marks the highest level of freedom and 7, the lowest level. The bottom quintile has an average score of 5.0. (Exhibit 1.21)

Economic Freedom and Peace

In chapter 2, Erik Gartzke, a political scientist from Columbia University, shows that economic freedom reduces violent conflict. As well, he compares the impact of economic freedom on peace to that of democracy on peace. Researchers have long known democracies go to war about as often as other nations but tend not to go to war with each other. However, stable democracies typically have strong levels of economic freedom, leading to the question of whether it is democracy or economic freedom that affects the probability of violent conflict.

Economic freedom creates a substantial peace dividend

- ◆ When measures of both economic freedom and democracy are included in a statistical study, economic freedom is about 50 times more effective than democracy in diminishing violent conflict.
- ◆ The impact of economic freedom on whether states fight or have a military dispute is highly significant (at the 1% level) while democracy is not a statistically significant predictor of conflict.
- ◆ Nations with a low score for economic freedom (below 2 out of 10) are 14 times more prone to conflict than states with a high score (over 8) (figure 2.1).
- ◆ The overall pattern of results does not shift when additional variables, such as membership in the European Union, nuclear capability, and regional factors, are added (tables 2.2, 2.3, 2.4).

Economic freedom and competitive markets promote peaceful co-existence by altering incentives

- ◆ Wealth and power are created by markets and the efficient production that arises from them, not by conquest of land or raw materials.
- ◆ Changes in the nature of production in modern capitalist states make conquest unprofitable.
- ◆ Wealth created by market economies through efficient production, unlike wealth derived from land or resources, is difficult for nations to “steal” by violent action since efficient production requires property rights and free decisions by market participants that are difficult or impossible to coordinate to the victor’s advantage.
- ◆ Markets provide political leaders with more accurate signals and make it more costly for them to use threats to mislead potential opponents. This improves the effectiveness of bargaining, expands the area of mutual gain, and thereby reduces the likelihood of military conflict.