Prospering From Freedom's Riches

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OVER the last two decades, Australia slowly but steadily adopted a new national 'vision'. One based on economic freedom—open markets, freer trade, less regulation, limited government and sound money.

We were not alone; indeed many nations of the world have, to varying degrees, adopted this 'vision'.

The rationale was simple: economic freedom is seen as the key to prosperity. When people have freedom—to go into business and occupations of their own choosing, to reap profit and suffer losses from their activities, to save and invest, to enjoy the use of their property, and to join in voluntary exchange with each other—they produce more. With time, these more productive societies will become prosperous.

As argued elsewhere (Switzer, page 5; Moran pages 6–7), this vision is now under sustained attack in Australia and around the world. Many dispute its central premise—that freedom leads to prosperity. Others agree that it has led to growth in developed countries such as Australia, but believe that these gains have not been widely shared within and across countries.

What is the evidence?

Thanks to a project—the Economic Freedom Project[1]—initiated more than a decade ago by the Fraser Institute of Vancouver, Canada, we have the data to begin to answer some of these questions.

And the findings are very positive—at least from the perspective of economic freedom.

The Fraser Institute, together with 53 think-tanks (including the IPA), have developed a composite set of indices using published data covering 123 countries. The indices are based on 21 data sets covering seven areas: size of government, economic structure and use of markets; price stability; exchange of currency; legal structure and property rights; trade in goods and services; and financial and capital markets.

Among other things, the data provide an overall economic freedom index by country over time which in turn provides a statistical base for examining relationships between economic freedom and other factors such as growth, income, human development, poverty, and corruption.

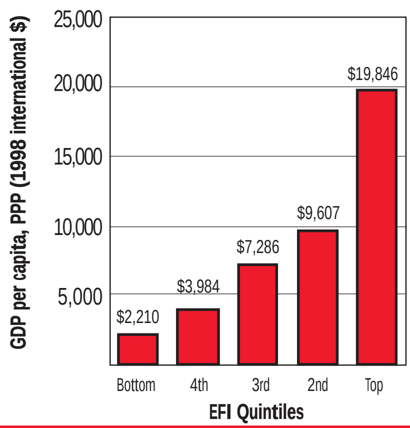
THE FINDINGS

First, the report confirms that Australia has significantly freed up its economy over the last 25 years and, as a result, has become one of the most open economies in the world. In 1975, Australia had an economic freedom rating of 6.5 out of a maximum of 10, which ranked it 17th out of 123 nations. By 1999, Australia's economic rating had improved significantly to 8.5, pushing up its overall ranking to sixth.

Although Australia ranks below Hong Kong, Singapore, New Zealand, the UK and the US, the gap is getting smaller and in many areas is small-to-negligible. Indeed, Australia lags the top nations significantly in only three areas: labour markets, tax, and welfare transfers.

Australia is not alone in its recent pursuit of economic freedom. During the same period, New Zealand went from a ranking of 35th to third, the UK went from 18th to fourth, and Ireland went from a ranking of 27th to sixth—or equal with Australia. In fact, Ireland's adoption of economic freedom and its contribution to its incredible economic turnaround is one of the big, overlooked stories of the last decade.

Chart 1: Economic Freedom and Income



Second, the report finds strong and positive relationships between economic freedom on the one hand and wealth and economic growth on the other.

As shown in Chart 1, countries in the top quintile (20 per cent) of the 'most economically free' countries have an average per capita GDP of $US19,846—over twice the income level of the next quintile of countries—while countries in the bottom 20 per cent of countries had an aver-

Chart 2: Economic Freedom and Growth

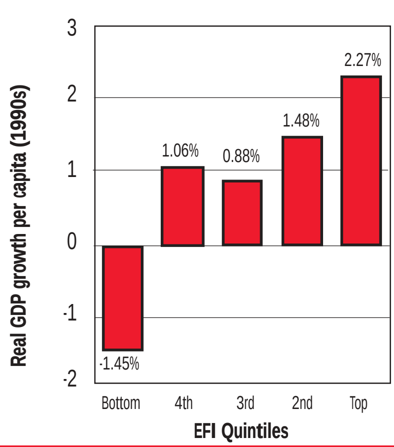


Chart 3: Economic Freedom and Unemployment (20 OECD Countries, 1993-96)

Chart 5: Economic Freedom and Human Development

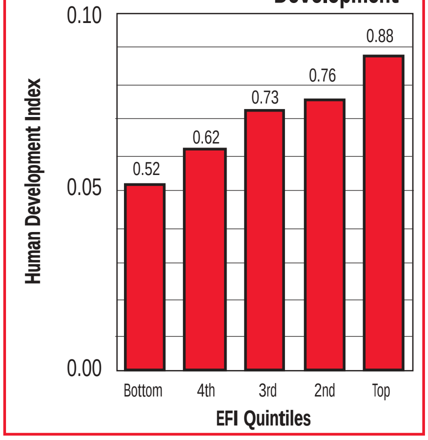
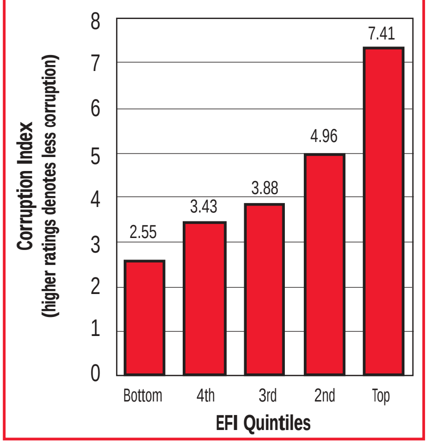


Chart 6: Economic Freedom and Corruption



age per capita GDP of just $US2,210.

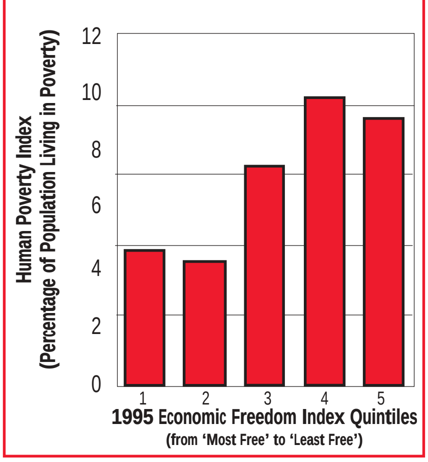
Economically-free countries also tend to grow faster. As shown in Chart 2, over the 1990s, the higher the level of economic freedom, the higher the average rate of growth, with the most-free nations recording an average growth rate in real GDP per capita of 2.27 per cent and the least-free nations experiencing an average growth rate of -1.45 per cent.

This result is not quarantined to wealthy countries. Although wealthy countries, of course, dominate the ranks of the most free, the largest gains in terms of wealth and economic growth have been made by those formerly poor countries—such as Singapore and Hong Kong—which most strongly adopted economic freedom.

Third, economic freedom tends towards a more inclusive society.

The most important indicator of inclusiveness is the unemployment rate. One cannot share in freedom and wealth over the long term without access to work. As shown in Chart 3 (using data only for the OECD countries during the 1993–96 period), except for countries in the third quintile, greater economic freedom is associated with lower unemployment rates.[2]

Chart 4: Economic Freedom and Poverty



Another indicator of inclusiveness is the rate of poverty. Poor people can face huge barriers not only to gaining jobs but also to education and health services. As shown in Chart 4, using data from the UN's Human Poverty Index, there is a negative relationship between economic freedom and poverty. That is, the proportion of the population afflicted by poverty is generally greater the less free is the economy.

The message is also positive using a broader measure of well-being, such as the UN's Human Development Index which 'measures a country's achievements in three aspects of human development: longevity, knowledge and a decent standard of living'. As shown in Chart 5, the higher the level of economic freedom, the greater the level of human development index—that is, the higher the level of economic freedom, the higher the quality of life.

Another fundamental indicator of inclusiveness is the level of corruption. Corruption limits access to opportunities and services. It, more than anything else, is the cause of policy failure and poverty within nations. As shown in Chart 6, higher levels of economic freedom correlates with less corruption. This is no surprise, as economic freedom—free trade, open markets, limited government, etc.—act directly against the base of corruption—that is, the ability of government officials to restrict access to markets and resources.

SUMMARY

The evidence shows that economic freedom has lived up to expectations. It has tended to lead to prosperity, in wealthy as well as in poor nations. It has also tended to enhance the ability of people and nations to share in wealth and opportunity.

Some nations have not fared well in relative and absolute terms over the last two decades and their decline has, in part, been caused by the worldwide trend to free economies, or rather to their *failure* to join this trend. The nations which have fared worse have been those with the lowest levels of economic freedom. The nations that have gained the most are those poor ones that changed their policies to adopt more free and open markets.

NOTES

1. The latest annual report, *Economic Freedom of the World Report 2001*, is available at www.freetheworld.com.
2. Charts 3 and 4 from Grubel, Herbert G. (1998), 'Economic Freedom and Human Welfare: Some Empirical Findings', *Cato Journal*, 18 (2), (Fall): 287–304. The data set for Chart 4 included only 55 countries.