

Chapter 1

Economic Freedom: The Proven Path to Prosperity

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The data collected in the *Index of Economic Freedom* provide strong evidence that economic freedom is a prerequisite for sustainable human and societal development. Historically, nations with higher degrees of economic freedom have flourished both economically and socially. Freer societies are better able to capitalize on the virtues of the free-market system in responding to the decisions and desires of individuals in constructive and efficient ways. They provide more and more varied opportunities for individuals and tend to create virtuous growth cycles characterized by efficient resource allocation, high value creation, and innovation.

Put simply, the freer the economy, the more productive and prosperous its citizens are likely to be. Policies that promote economic freedom, whether through improvements in the rule of law, the promotion of efficiency and openness, or suitable restraints on the size and reach of government, therefore provide the environment that can best inspire people to develop practical solutions to economic and social challenges confronting the world.

ECONOMIC FREEDOM EMPOWERS INDIVIDUALS

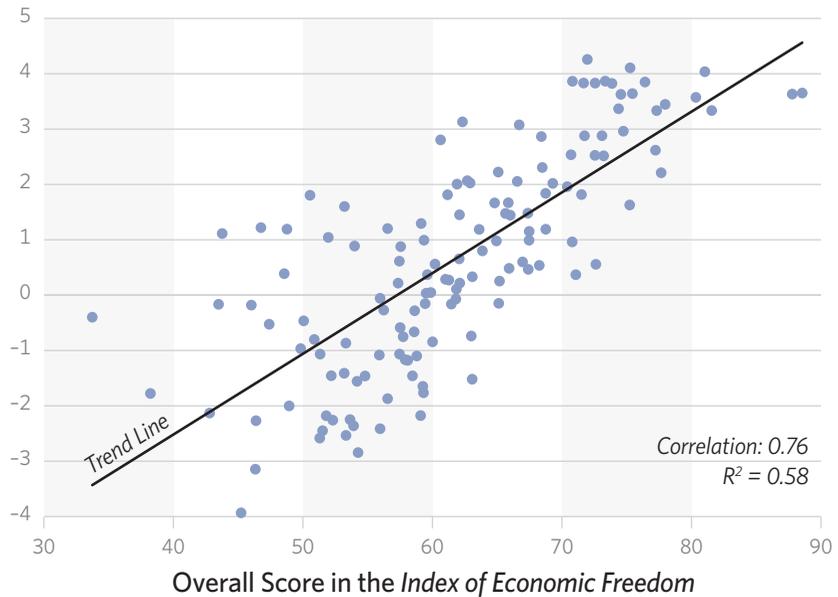
The *Index* results provide compelling evidence that economic dynamism is best sustained when governments institutionalize economic policies that empower individuals. When people have more choices, they are more likely to engage in entrepreneurial activity. In turn, it is entrepreneurial activity that creates jobs, investment opportunities, and the new products and services that enrich our lives. In many respects, economic freedom is just shorthand for an environment that encourages entrepreneurship. Chart 1 shows the close correspondence between economic freedom and entrepreneurial opportunity.

One dependable result of vibrant entrepreneurial opportunity is resilient economic growth, a key policy goal for most governments. Growth is maximized when individual consumers, investors, and producers are able to exercise their best individual judgment in identifying, assessing, and realizing opportunities.

Economic Freedom Promotes Entrepreneurial Dynamism

Entrepreneurship and Opportunity Score

Each circle represents a nation in the *Index of Economic Freedom*

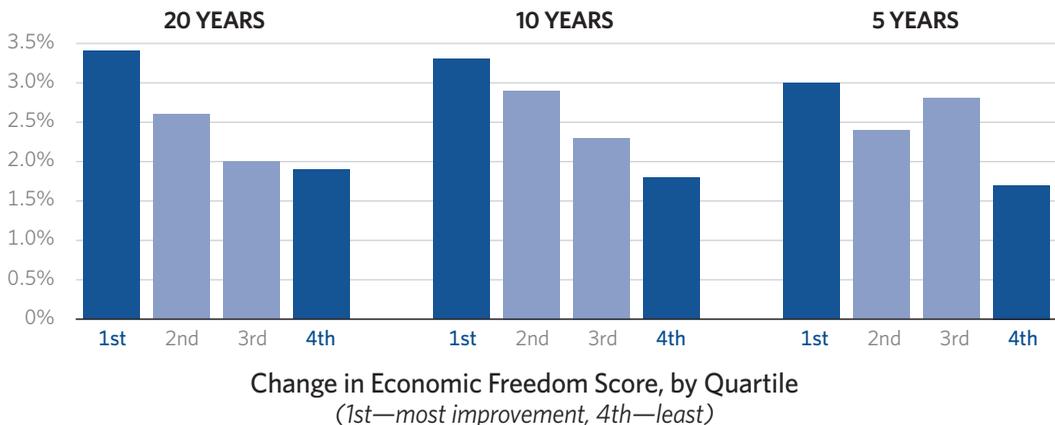


Sources: Terry Miller and Anthony B. Kim, *2016 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2016), <http://www.heritage.org/index>, and Legatum Institute Foundation, "2015 Legatum Prosperity Index," 2015, <http://www.li.com/activities/publications/2015-legatum-prosperity-index> (accessed December 8, 2015).

Chart 1 heritage.org

Advancing Economic Freedom Leads to Higher Economic Growth

Average Annual Growth in Real Per Capita GDP



Sources: Terry Miller and Anthony B. Kim, *2016 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2016), <http://www.heritage.org/index>, and The World Bank, World Development Indicators Online, <http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators> (accessed December 8, 2015). Changes in economic freedom score have been calculated as the annual compound growth rate.

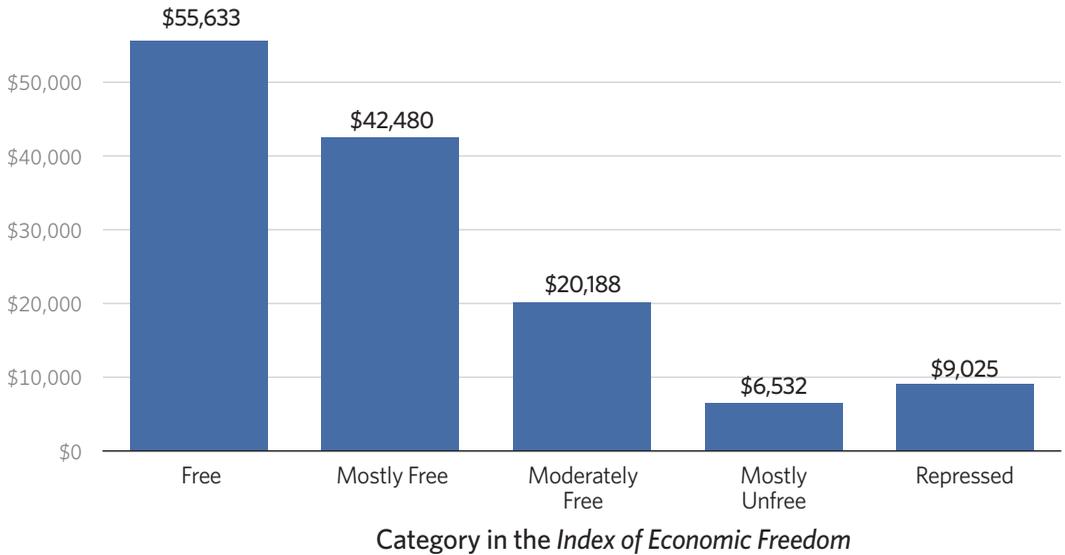
Chart 2 heritage.org

Economic Freedom and Prosperity

GDP per Capita (Purchasing Power Parity)



GDP per Capita (Purchasing Power Parity)



Sources: Terry Miller and Anthony B. Kim, *2016 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2016), <http://www.heritage.org/index>, and International Monetary Fund, World Economic Outlook Databases, <http://www.imf.org/external/ns/cs.aspx?id=28> (accessed December 8, 2015).

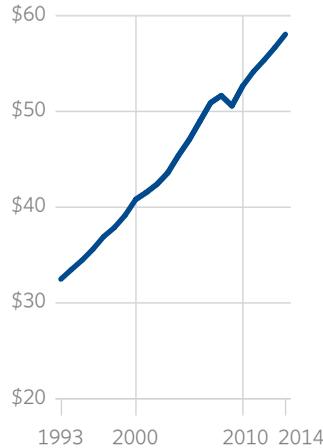
Chart 3 heritage.org

As Economic Freedom Rises, the Global Economy Expands and Poverty Falls

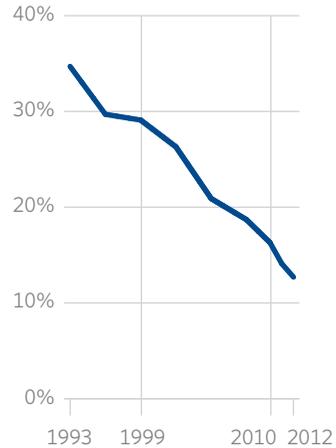
Average Score in the Index of Economic Freedom



Global GDP, in Trillions of 2005 U.S. Dollars



Percent of Global Population in Poverty



Sources: Terry Miller and Anthony B. Kim, *2016 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2016), <http://www.heritage.org/index>; The World Bank, World Development Indicators Online, <http://databank.worldbank.org/data/views/variableSelection/selectvariables.aspx?source=world-development-indicators> (accessed December 8, 2015); and The World Bank, PovcalNet, <http://iresearch.worldbank.org/PovcalNet/index.htm?1> (accessed December 8, 2015). Some figures have been interpolated.

Chart 4  heritage.org

As Chart 2 demonstrates, there is a robust relationship between improving economic freedom and achieving faster economic growth. Whether long-term (20 years), medium-term (10 years), or short-term (five years), the relationship between changes in economic freedom and rates of economic growth is consistently positive. The average annual per capita economic growth rates of countries in which economic freedom has grown the most are at least 50 percent higher than those of countries where freedom has stagnated or slowed.

ECONOMIC FREEDOM IMPROVES LIVING STANDARDS

Equally notable are the fundamental benefits that result from the strong positive relationship between economic freedom and levels of per capita income. For countries achieving scores in the *Index* 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 3, countries higher up the economic freedom scale show increasingly high levels of average income. Economies rated “free” or “mostly free” in the *Index* enjoy incomes that are over twice the average levels in all other countries and more than four times higher than the incomes of “repressed” economies.

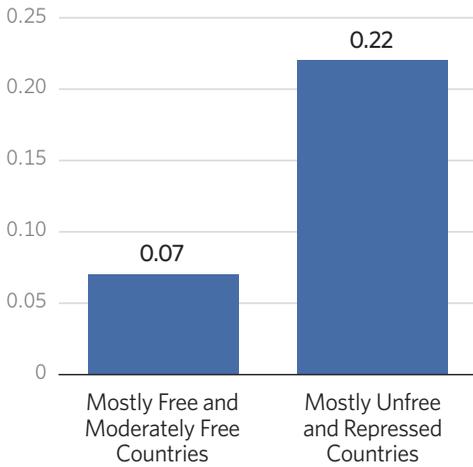
ECONOMIC FREEDOM ALLEVIATES POVERTY AND FOOD INSECURITY

The free-market system that is rooted in the principles of economic freedom has fueled unprecedented economic growth around the world. As Chart 4 illustrates, as the global economy has moved toward greater economic freedom over the past two decades, real world GDP has increased by about 80 percent, and the global poverty rate has been cut in half, lifting hundreds of millions of people out of poverty.

Greater economic freedom has had a positive impact not just on the number of people in poverty, but also on the intensity of the poverty still experienced by some. Poverty intensity, which

Economic Freedom and Poverty Intensity

Poverty Intensity



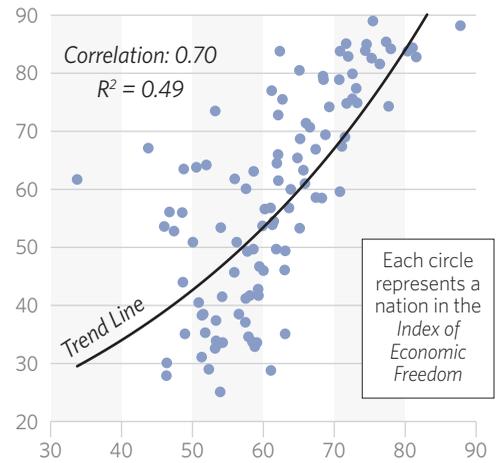
Categories in the Index of Economic Freedom

Sources: Terry Miller and Anthony B. Kim, *2016 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2016), <http://www.heritage.org/index>, and U.N. Human Development Programme, "Human Development Report 2014," 2014, <http://hdr.undp.org/en/content/human-development-report-2014> (accessed December 8, 2015).

Chart 5 heritage.org

Economic Freedom and Food Security

Global Food Security Index



Overall Score in the Index of Economic Freedom

Sources: Terry Miller and Anthony B. Kim, *2016 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2016), <http://www.heritage.org/index>, and The Economist Intelligence Unit, *Global Food Security Index*, May 19, 2015, <http://foodsecurityindex.eiu.com/> (accessed December 8, 2015).

Chart 6 heritage.org

considers degrees of deprivation at the individual level in education, health outcomes, and standards of living, is much lower on average in countries with higher levels of economic freedom. Chart 5 shows that the intensity of poverty in countries with economies that are considered mostly free or moderately free is only about one-third the level in countries that are rated less free.

Also noteworthy is the growing attention that has been given in recent years to the importance of ensuring food security, a critical dimension of fighting poverty, particularly in developing and underdeveloped countries. More aid money cannot and will not safeguard food security. The task is multidimensional and closely linked to achieving agricultural development, economic growth, institutional stability, openness to trade, and overall social progress. It is ultimately about

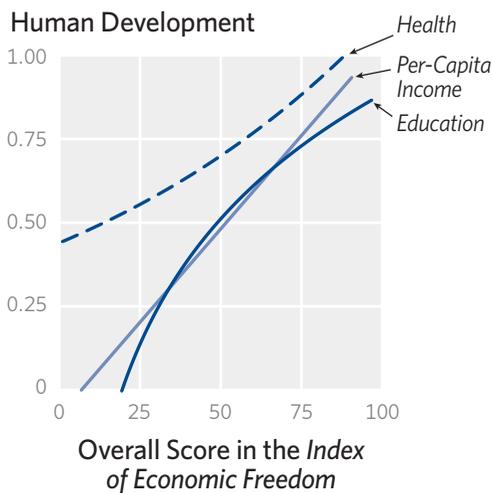
advancing and sustaining economic freedom so that a virtuous cycle of growth and development can occur meaningfully for a greater number of ordinary people. As shown in Chart 6, economic freedom is an indispensable ingredient in enhancing food security.

ECONOMIC FREEDOM PROMOTES HUMAN DEVELOPMENT

Economic freedom is not just about financial success. Achieving greater overall prosperity that goes beyond the materialistic and monetary dimensions of well-being is equally important. 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 human development

Greater Freedom Means Greater Performance by Several Measures



Sources: Terry Miller and Anthony B. Kim, *2016 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2016), <http://www.heritage.org/index>, and U.N. Human Development Programme, International Human Development Indicators, <http://hdr.undp.org/en/statistics/> (accessed December 8, 2015). Human Development values have been converted to a 0-1 scale.

Chart 7 heritage.org

in terms of life expectancy, literacy, education, and overall quality of life. As Chart 7 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.

ECONOMIC FREEDOM ENCOURAGES ENVIRONMENTAL PROTECTION

Interestingly, the same free-market principles that have proven to be the key to human development have also proven to deliver environmental success. In some countries, government policies and actions concerning the environment have become more intrusive and economically distortionary. Many governments have pushed programs to tax carbon emissions and increase taxes on gasoline, have organized non-transparent and sometimes corrupt exchanges for the buying and selling of

carbon emissions, and have provided subsidies for “clean” energy to politically favored firms. Such policies impose a huge direct cost on society and retard economic growth—and all for uncertain environmental benefits.

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 technology and trade. Around the world, economic freedom has been shown to increase countries’ capacity for innovation and, by extension, their ability to improve their overall environmental performance. The positive link between economic freedom and higher levels of innovation ensures greater economic dynamism in coping with environmental challenges. (See Chart 8.) A virtuous cycle of investment, innovation (including in greener technologies), and dynamic economic growth has flourished where governments have trusted market forces and competition to spur environmental efficiency.

ECONOMIC FREEDOM FACILITATES INCLUSIVE DEMOCRATIZATION

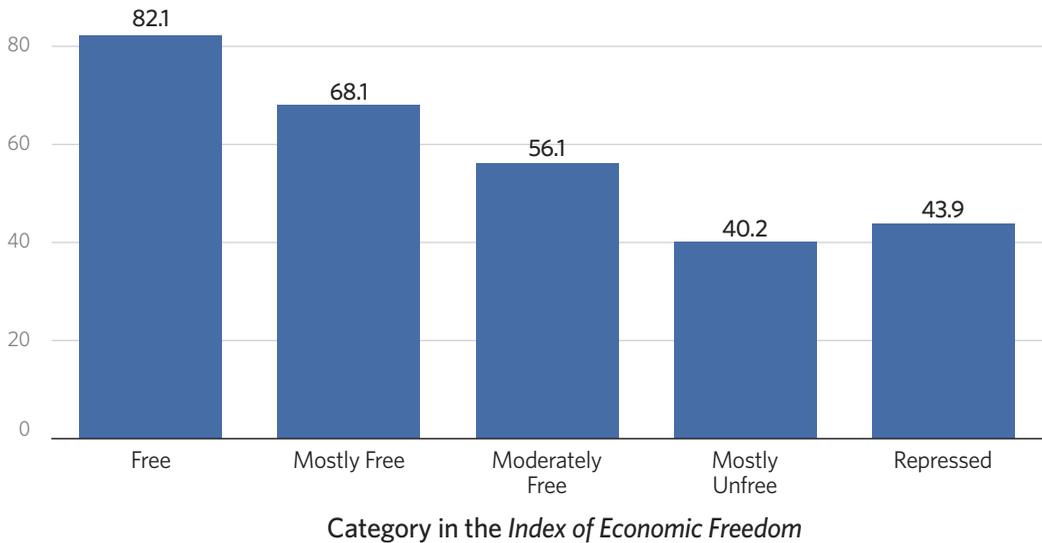
Greater economic freedom can also provide more fertile ground for effective democratic governance. By empowering people to exercise greater control of their daily lives, economic freedom ultimately nurtures political reform by making it possible for individuals to gain the economic resources they need to challenge entrenched interests and compete for political power, thereby encouraging the creation of more pluralistic societies.

Pursuit of greater economic freedom is thus an important stepping-stone to democratic governance. It is a philosophy that encourages individual initiative and disperses economic power and decision-making throughout society, building the middle class. Undoubtedly, achieving greater political freedom through well-functioning democracy is a messy and often excruciating process. However, as shown in Chart 9, the positive relationship between economic freedom and democratic governance is undeniable.

Economic Freedom, Innovation, and the Environment



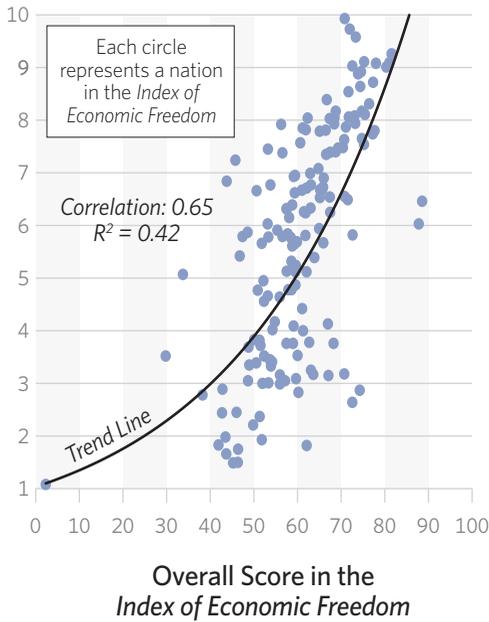
Environmental Performance Index



Sources: Terry Miller and Anthony B. Kim, *2016 Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2016), <http://www.heritage.org/index>; Cornell University, INSEAD, and World Intellectual Property Organization, *The Global Innovation Index 2015* (Geneva: World Intellectual Property Organization, 2015), <https://www.globalinnovationindex.org/content/page/GII-Home> (accessed December 8, 2015); and Yale University, "2014 Environmental Performance Index," <http://epi.yale.edu/epi> (accessed December 8, 2015).

Economic Freedom and Democratic Governance

Index of Democracy

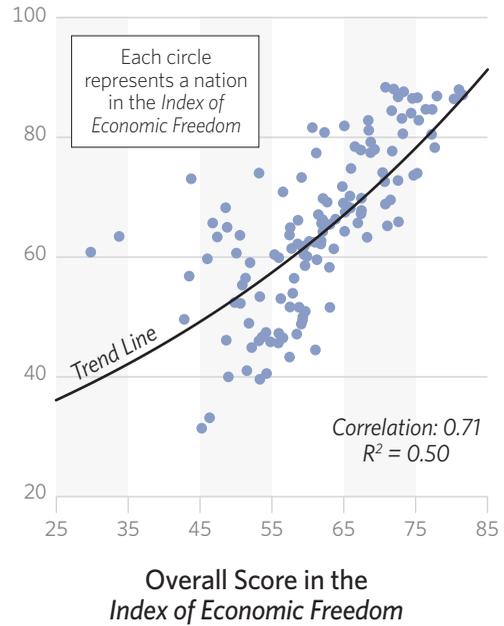


Sources: Terry Miller and Anthony B. Kim, 2016 *Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2016), <http://www.heritage.org/index>, and The Economist Intelligence Unit, "Democracy Index 2014," https://www.eiu.com/public/topical_report.aspx?campaignid=Democracy0115 (accessed December 8, 2015).

Chart 9 heritage.org

Economic Freedom and Social Progress

Social Progress Index



Sources: Terry Miller and Anthony B. Kim, 2016 *Index of Economic Freedom* (Washington, DC: The Heritage Foundation and Dow Jones & Company, Inc., 2016), <http://www.heritage.org/index>, and Social Progress Imperative, "Social Progress Index 2015," <http://www.socialprogressimperative.org/data/spi> (accessed December 8, 2016).

Chart 10 heritage.org

ECONOMIC FREEDOM ENSURES UPWARD MOBILITY

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 outcomes. Over the past two decades, this debate has largely been won by free-market capitalism. However, fears that the immediate benefits of capitalism are fading has brought to the forefront concerns about economic mobility and economic freedom.

Some naysayers have claimed that economic and social progress has been limited in recent years as incomes in some countries have become more unequal as a result of economic freedom. The evidence does not support this contention.

In fact, it is countries that more fully embrace economic freedom that have provided the environments most conducive to social progress. (See Chart 10.) Countries that have improved their competitiveness and opened 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 levels 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.

THE WAY FORWARD: PROSPERITY THROUGH ECONOMIC FREEDOM

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 supported by efficient regulations and open to the free flow of goods, services, and capital, have participated in an era of globalization that has generated dramatic improvements in living standards, including—and perhaps even especially—in poorer countries.

The global lesson is that economic freedom paves the way for rapid development. Through the advancement of economic freedom, increasing numbers of people have gained access to knowledge and opportunities unheard of even a generation ago. Not all start from the same place in the competitive environment of the global economic system, but with economic freedom, all have the opportunity to progress toward greater prosperity.

The *Index of Economic Freedom* is replete with practical examples of such accomplishments from countries in every region, at every level of development, and from a wide variety of cultural and historical backgrounds.