

THE PROGRESS REPORT

Testing Economic Freedom

By Fred E. Foldvary

Economic theory tells us that government intervention in the form of taxes, excessive regulation, and arbitrary restrictions, reduces output and growth. The law of demand tells us that with lower costs, we get more wealth at a lower prices. So to get the greatest possible prosperity, we need what Henry George called "true free trade," the removal of all barriers to production.

That's the theory, but skeptics quite properly demand to see the evidence. And one or two examples here and there is not good enough, since that might be a coincidence, or other factors could be causing the prosperity. So to confirm the theory that a truly free market brings about the most prosperity and economic growth, we need a comprehensive and systematic test of real-world experience. Until recently, such a test was lacking.

To conduct the test, a network of institutes around the world, led by the Fraser Institute of Canada, got together on the project. The result was the book, *Economic Freedom of the World 1975-1995*, published in 1996. The project studied more than 100 countries for the years 1975-95. They came up with four major categories of economic freedom: money and inflation, government operations and regulations, takings and discriminatory taxation, and restraints on international exchange. For each of the categories, there were several components that they measured. For each country, they obtained index values for 17 components. They then tested the index summary for each country against its per-capita GDP (gross domestic product) and rate of growth.

The results were a very strong correlation or relationship between economic freedom and growth and prosperity. Dividing the countries into five groups, from poorest to richest, both per-capita GDP and growth of GDP are consistently higher when there is more economic freedom. Also, countries such as Chile which improved their economic freedom had high growth rates, and those in which economic freedom declined scored low in growth or even declined.

The countries ranking highest in economic freedom, according to the study, are Hong Kong, New Zealand, Singapore, and the United States. Closely behind them are Switzerland, the United Kingdom, Canada, Australia, Ireland, Japan, Netherlands, Germany, Belgium, and Malaysia. Note that only economic freedom was measured, not political freedom. The study found that there has been an overall increase in economic freedom since 1985.

The results are impressive and clear: economies with more economic freedom are wealthier and grow faster. This is not surprising to those who favor free markets, but should provide the skeptics with the evidence they claim to seek. The study found that high marginal tax rates - taxes on getting more income - are bad for growth. The ultimate free-market marginal tax rate is zero, which is what we get when we tax rent and untax labor and enterprise. The policy implications are clear: eliminate excessive regulations and arbitrary restrictions, and lower taxes to the ground.

