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GWARTNEY, LAWSON & HALL: Declining economic freedom

Restricting liberty inevitably means slower growth

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In the early 1980s, under the leadership of Ronald Reagan and Margaret Thatcher, the United States and the United Kingdom reduced marginal tax rates, brought inflation under control and relaxed both regulations and trade barrier Many other countries soon followed, and the result was a quarter-century of expansion in both economic freedom and the growth of income. From 1980 to 2007, there was a gradual but steady movement toward economic freedor

These movements can be observed in the data of the just-released Economic Freedom of the World: 2010 Annual Report.

However, as this year's report shows, the world's economic freedom rating in 2008 fell for the first time in several decades. Of the 123 countries with ratings in 2007 and 2008, 88 (71.5 percent) exhibited rating decreases and just 35 (28.5 percent) recorded rating increases.

The U.S. dropped from third in 2000 to sixth in the current report, as its rating declined from 8.45 in 2000 to 7.93 i 2008.

The Economic Freedom of the World (EFW) index measures the consistency of a nation's institutions and policies with economic freedom. Put simply, institutions and policies are consistent with economic freedom when they permit individuals to choose for themselves and enter into voluntary agreements with others and when they protect individuals and their property from aggressors.

In order to achieve a high EFW rating on the zero-to-10 scale of the EFW index, a country must provide secure protection of privately owned property, evenhanded enforcement of contracts and a stable monetary environment. also must keep taxes low, refrain from creating barriers to both domestic and international trade and rely more full on markets rather than the political process to allocate goods and resources.

The rating reduction in the United States was primarily the result of lower ratings in the security of property rights but the huge increase in government borrowing also was a contributing factor. The increased government expenditures, larger deficits and increased regulations of the past two years are sure to push the U.S. economic freedom rating even lower in the years immediately ahead.

We know more about the sources of growth and prosperity than ever before. Economic growth is primarily the result of gains from trade, capital investment and the discovery of improved products, lower-cost production methods and better ways of doing things. Numerous studies have shown that countries with more economic freedo grow more rapidly and achieve higher levels of per-capita income than those that are less free. Similarly, there is a positive relationship between changes in economic freedom and the growth of per-capita income. Moreover, as pe capita income has grown, the world's poverty rate has declined, and most of this progress has occurred in countries that have made substantial moves toward higher levels of economic freedom.

The world now faces a situation similar to that of the Great Depression. During the 1930s, perverse economic policies transformed a normal cyclical downturn into a decade-long era of hardship and suffering. Even though it was caused by perverse policies, the Great Depression led to even more government regulation, growth of government spending and reductions in economic freedom. Will the same thing happen this time? Will we once again choose more government and less economic freedom?

We are in the midst of a great debate between the proponents of limited government and open markets on the one hand and those favoring more collectivism and political direction of the economy on the other. The outcome of thi debate will determine the future direction of both economic freedom and the prosperity of Americans and others throughout the world.

James Gwartney of Florida State University, Robert Lawson of Auburn University and Joshua Hall of Beloit College are the co-authors of the Economic Freedom of the World: 2010 Annual Report, co-published by the Cato Institute.