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America in free-fall

Economic freedom in the U.S. is dropping fast

Richard Rahn | Monday, September 17, 2012

The annual Economic Freedom of the World report, including an index of country rankings, has just been released, and it should be a wake-up call. The United States was known as the bastion of economic freedom for more than two centuries, and it was because of its economic freedom that the nation became the pre-eminent economic power. However, in just a few short years, the U.S. has fallen from No. 3 in 2000 (behind the city-states of Hong Kong and Singapore) to No. 8 in 2005 and to No. 18 in 2010, the last year for which complete statistics are available. Worse yet, the U.S. decline continues, and in next year's ranking, it is almost certain to be lower.

The main components of the index include the size of government (taxing and spending), legal systems, property rights, sound money, freedom to trade internationally, and regulation (including credit markets, labor and business regulations). The report says it "uses 42 different variables derived from sources such as the World Bank to measure the degree to which the institutions and policies of 144 countries are consistent with economic freedom." It is published by the Cato Institute in the United States, the Fraser Institute in Canada and a network of institutes in 78 other countries. The authors of the report are James Gwartney of Florida State University, author of a major economics textbook and former chief economist of the Joint Economic Committee of the U.S. Congress, Robert A. Lawson of Southern Methodist University and Joshua Hall of Beloit College.

The godfather of the Economic Freedom of the World report was Milton Friedman (1912-2006), who said that "if economic freedom could be measured with greater accuracy, it would be possible to isolate its impact on the performance of economies and other factors of interest." Since the report was first published in 1996, it has provided overwhelming evidence that economic freedom is highly correlated with economic progress, liberty and well-being.

A few facts will help illustrate why economic freedom is so important. The freest quartile of countries had an average per capita income of $37,691, while the least free quartile had a per capita income of just $5,188 in 2010. The freest quartile grew at an average annual rate of 3.6 percent 1990-2010, while the quartile that was least free only grew at an average rate of 1.6 percent over the same period. Life expectancy in the freest quartile was 79.5 years in 2010, as contrasted with 61.6 years in the least free quartile. Those people who are more concerned about the poor than economic growth should take note that the poorest 10 percent in the least-free quartile only had a per capita income of $1,209 in 2010, as contrasted with a per capita income of $11,382 for the poorest 10 percent in the freest quartile. Greater economic freedom is also associated with more political and civil liberties. In sum, by almost any measure of human well-being, a person is far better off being in a country with a high degree of economic freedom than in one with restricted economic freedoms.

As the accompanying table shows, countries can rise and fall rapidly. The former communist states of Bulgaria and Poland have become far freer economically very quickly. In contrast, Argentina and Venezuela have become two of the least free, and their people are suffering as a result.

Why has the United States fallen so far so fast? For years, the U.S. was near the top in economic freedom for a major country. The United States now is behind not only Canada and Australia, but also Finland, Chile and even the small island nation of Mauritius, off the east coast of Africa. The U.S. has declined in the rule of law and property rights because of such things as "the ramifications of the wars of terrorism and drugs, and violation of the rights of bondholders in the bailout of automobile companies." The country also has suffered because of a decline in the freedom to trade internationally, fiscal deficits caused by the growth in government, and various forms of regulation.

The report's authors note that the one-point decline in the U.S. rating is associated with a "reduction in long-term growth of [gross domestic product] of between 1.0 and 1.5 percentage points annually. This implies that unless policies undermining economic freedom are reversed, the future annual growth of the U.S. economy will be half its historic average of 3 percent."

During this election season, the U.S. should be having a national debate about what can be done to restore economic freedom. It is perhaps no surprise that the Obama administration has been silent on the issue, because many of its policies have caused the decline. But Mitt Romney also has had little to say about it. Economic freedom grew under President Reagan, and he made its decline under President Carter an issue in his campaign. Jack Kemp made his name in promoting economic freedom and growth, which resonated with the American people. It is hoped that this report, detailing the shockingly steep U.S. decline, will wake up the Romney campaign team and the mainstream media.

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