

THE CENTRAL ROLE OF ECONOMIC FREEDOM IN DEMOCRACY

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“Economic freedom allows for independent sources of wealth that serve both to counterbalance political power and to nourish a pluralistic society,” says author Ian Vásquez. In this article, he presents evidence that in countries with the freest economies, citizens also enjoy comparatively high standards of living, and he discusses the interplay between the rule of law and economic freedom. Vásquez is the director of the Project on Global Economic Liberty at the Cato Institute in Washington, D.C., and a term member of the Council on Foreign Relations.



Of the cherished liberties of a free society—economic, political, and civil—economic freedom holds a special place. It is not only an end in itself; economic freedom gives sustenance to the other freedoms. When personal choice, voluntary exchange,

and the protection of private property are not secure, it is difficult to imagine how political freedom or civil liberties can meaningfully be exercised.

In 1962, Nobel laureate in economics Milton Friedman observed:

History speaks with a single voice on the relation between political freedom and a free market. I know of no example in time or place of a society that has been marked by a large measure of political freedom, and that has not also used something comparable to a free market to organize the bulk of economic activity.

The collapse of central planning in Third World countries and of socialism itself in the past 20 years seems to support Friedman’s thesis. The rise in

economic freedom has accompanied that of political and civil freedom around the world, and both have been significant as countries have moved away from authoritarianism and opened their markets.

ECONOMIC FREEDOM

Economic freedom is a desirable end unto itself because it generally expands the range of choice of the individual, both as a consumer and as a producer. The larger role of economic freedom in society, however, is often under-appreciated, including by those who believe in political pluralism; human rights; and freedom of association, religion, and speech.

Yet the decentralization of economic decision-making supports civil society by creating the space in which organizations of all kinds can exist without depending on the state. A nation in which there is economic freedom is one in which the private sector can fund the institutions of civil society. Thus genuinely independent churches, opposition political parties, and a diversity of businesses and media are more likely to exist where economic power is not concentrated in the hands of bureaucrats or politicians.

By definition, economic liberalization implies a loss of full political control over the citizenry. That is something that authoritarian governments around the world have been finding out in the current era of globalization. Dictatorships have given way to democracies in countries that began liberalizing their markets as early as the 1960s and 1970s, including South Korea, Taiwan, Chile, and Indonesia. With the election of President Vicente Fox in 2000, Mexico’s market liberalization in the 1990s helped end more than 70 years of the PRI’s (Institutional Revolutionary Party’s) one-party rule, once referred to by Peruvian novelist Mario Vargas Llosa as “the perfect dictatorship.”

Economic freedom allows for independent sources of wealth to counterbalance political power and to nourish a pluralistic society. When the state owns or exerts undue control over banking, credit, telecommunications, or

newsprint, for example, it controls not only economic activity, but expression as well. It has taken the world far too long to recognize the truth in the statement of early 20th-century writer Hilaire Belloc that “the control of the production of wealth is the control of human life itself.”

Thus the dilemma that China’s Communist Party currently faces is familiar. To maintain social stability, China must continue the economic liberalization that has fueled more than two decades of high growth. But market reforms have given hundreds of millions of Chinese greater independence from the state and have created an emerging middle class that increasingly demands political freedom and representation. The party wishes to maintain political power, but economic liberalization is undermining that goal, while ending liberalization would reduce growth and cause instability.

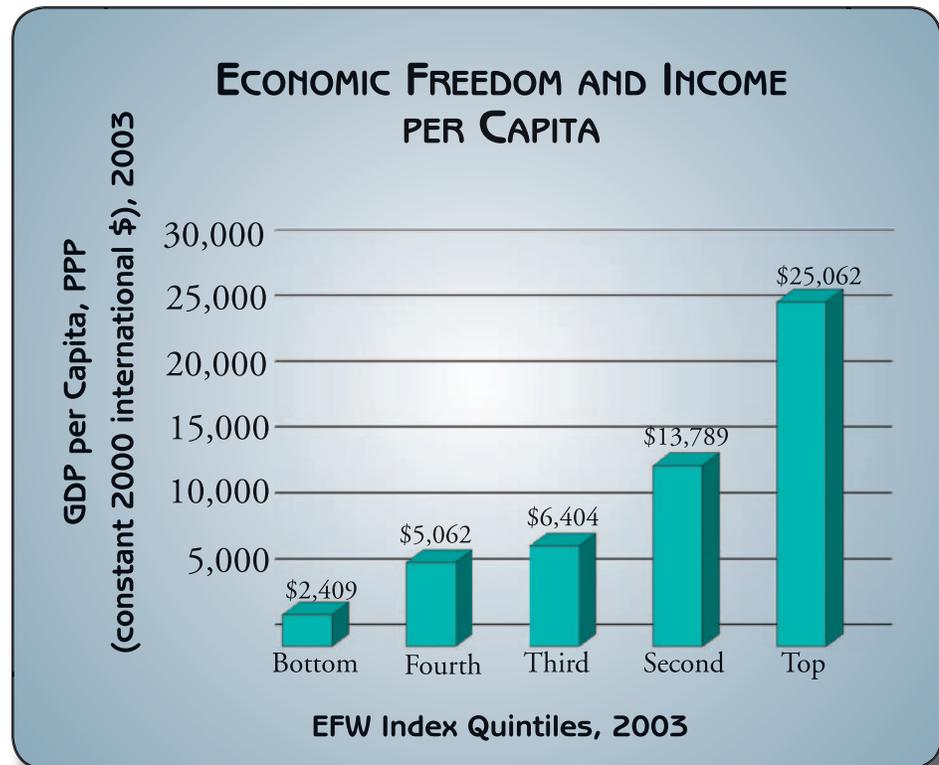
As in the case of China and countless other nations, economic freedom encourages political pluralism by promoting the growth that produces a middle class and citizens less dependent on the state. Empirical evidence supports that relationship.

The most comprehensive empirical study on the relationship between a country’s economic policies and institutions and a country’s level of prosperity is the Canadian Fraser Institute’s *Economic Freedom of the World* report. It looks at 38 components of economic freedom, ranging from the size of government to the rule of law to monetary and trade policy, in 127 countries over a period of more than 30 years. The study finds a strong relationship between economic freedom and prosperity. The freest economies have an average per capita income of \$25,062 compared with \$2,409 in the least free countries. Free economies also grow faster than less free economies. Per capita growth in the past 10 years was 2.5 percent in the most free countries, while it was 0.6 percent in the least free countries.

The Fraser study also found that economic freedom is strongly related to poverty reduction and other indicators of progress. The United

Nations’ Human Poverty Index is negatively correlated with the Fraser index of economic freedom. The income level of the poorest 10 percent of the population in the most economically free countries is \$6,451 compared to \$1,185 in the least free countries. People living in the top 20 percent of countries in terms of economic freedom, moreover, tend to live about 25 years longer than people in the bottom 20 percent. Lower infant mortality, higher literacy rates, lower corruption, and greater access to safe drinking water are also associated with increases in economic liberty. The UN’s Human Development Index correlates positively with greater economic freedom. Significantly, so too does Freedom House’s index of political and civil liberties: Countries with more economic freedom tend to have more of the other freedoms as well.

Self-sustaining growth has, in fact, long depended on an environment that encourages free enterprise and the protection of private property. The West’s escape from mass poverty in the 1800s occurred in such an environment, which in turn initiated the era of modern economic growth. Even before then, the emergence of a commercial class of farmers in England led to its representation in Parliament, where in the 17th century it successfully limited arbitrary confiscations of wealth by the crown—in short, the rise of commercial farmers helped establish constitutional monarchy. Credible



Adapted from *Economic Freedom of the World: 2005 Annual Report*



AP/WWWP Yonhap, Choi Jae-koo

South Korean stock dealers cheer the KOSPI's record high at the Korea Exchange in Seoul in September 2005. Dictatorships have given way to democracies in countries that liberalized their markets as early as the 1960s and 1970s, including South Korea.

limitations on the power of government enhanced property rights and the rule of law, major factors in the rise of Great Britain as the world's preeminent economic and political power. As Great Britain grew wealthier, of course, it became a democracy.

More recent evidence supports the idea that growth and higher levels of income lead to, or at least help sustain, democracy. Political scientists Adam Przeworski and Fernando Limongi studied 135 countries between 1950 and 1990 and found that "per capita income is a good predictor of the stability of democracies." For example, they found that in countries with a per capita income below \$1,000 (in 1985 PPP dollars), democracies could on average expect to survive eight years. (PPP stands for purchasing power parity, a theory that states that exchange rates between currencies are in equilibrium when their purchasing power is the same in each of the two countries.) When incomes ranged between \$1,001 and \$2,000, the probability of democratic survival was 18 years. Those democracies in countries with incomes above \$6,055 could expect to last forever.

Economic freedom produces growth but does not always lead to democracy. Hong Kong and Singapore, among the world's freest economies, are notable examples. Nor is wealth alone always a product of economic freedom, as attested to by some resource-rich countries with relatively high incomes but where economic power is tightly controlled by the state; as expected, civil and political liberties are also severely limited in those countries. The central role of economic freedom in democracy, however, is clear. It can be a powerful force in

promoting democracy, and a good measure of economic freedom is necessary to sustain political freedom.

LIBERAL DEMOCRACY AND THE RULE OF LAW

Democracy is not a synonym of liberty. As we have seen, a democracy that is not accompanied by the other freedoms hardly succeeds in limiting the arbitrary power of political authorities, elected though they may be. Thus, much effort is currently being placed on promoting the rule of law—a central component of both liberal democracy and economic freedom.

It is axiomatic that the rule of law is necessary for a well-functioning democracy. Increasingly appreciated is the fact that the rule of law is also necessary for economic development. The *Economic Freedom of the World* report, for example, found that no country with a weak rule of law could sustain a solid rate of growth (more than 1.1 percent) once income per capita rose above \$3,400. In other words, once an economy reaches a certain level of development, improvements in the rule of law are essential to sustaining growth.

It is possible that, unlike tariff reductions or privatizations, the rule of law cannot be directly promoted. It may very well be that the rule of law happens after, or at about the same time that, other things are done right.

I advance a modest proposal. Instead of focusing on directly promoting the rule of law, we should be creating the environment within which the rule of law can evolve. Among other measures, that means promoting market reforms or economic freedom. For many poor countries, that includes reducing the size of government. The countries that today have a strong rule of law first established that institution and only later increased the size of their governments.

Unfortunately, too many poor countries are today trying to repeat that process in reverse. In countries as diverse as Brazil, Slovakia, the Republic of Congo, and Russia, for example, government spending as a share of gross domestic product exceeds 30 or 40 percent. Attempts to promote the rule of law where governments remain large are bound to fail or be exceedingly difficult. Indeed, although the trend during the past 20 years has been an increase in both economic and political freedom in the world, most countries still have a long way to travel down the path of economic freedom. Russia may have abandoned socialism, but it ranks 115 out of 127 countries in the *Economic Freedom of the World* index.

Author Fareed Zakaria observes, furthermore, that the majority of poor democracies in the world are illiberal



AP/WVVP Kaja-kadi Sepp

The Elcoteq mobile phone factory in Tallinn is a player in Estonia's bid for economic freedom, strengthening democracy there.

democracies—that is, political regimes in which liberties other than the freedom to choose who governs are not well established. He notes that in the West, the liberal constitutional tradition developed first and the transition to democracy developed later. In 1800, for example, only 2 percent of citizens voted in Great Britain, perhaps the most liberal society in the world at that time. Zakaria further points out that in non-Western nations that have

recently made a transition to liberal democracy, such as South Korea and Taiwan, capitalism and the rule of law also came first. That pattern may explain why regions like Latin America that have democratized first and then begun economic liberalization have had an especially challenging time at promoting economic freedom or growth.

Today, countries in Eastern and Central Europe, Latin America, and elsewhere are trying to achieve, with varying degrees of success, both democracy and economic freedom at the same time. In some cases, economic freedom has been rolled back or is no longer a priority, something that augurs poorly for democracy. In other cases, such as Estonia, economic freedom has steadily increased, thus strengthening democracy. Those of us who believe in democratic capitalism—whether we live in rich democracies, poor democracies, or autocratic states—should never lose sight of the central role of economic freedom in achieving a free society. ■

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