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Freedom, Entitlement, and the Path to Development

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Twenty years after the revolutions of Central and Eastern Europe, the Arab Spring is again raising some fundamental questions about the place of freedom and entitlement in development. Depending on the balance between free choices and more coerced decisions, individual opportunities to learn, own, work, save, invest, trade, protect, and so forth could vary greatly across countries and over time. Reviewing the economic performance of more than 100 countries over the past 30 years, new empirical evidence tends to support the idea that economic freedom and civil and political liberties are the root causes of why certain countries achieve and sustain better economic outcomes. In contrast, entitlement rights do not seem to have any significant effects on long-term per capita income—except for a possible negative effect. These results tend to support earlier findings that, beyond core functions of government responsibility (including the protection of liberty itself), the expansion of the state to provide for various entitlements (including so-called economic, social, and cultural rights) may not make people richer in the long run; it may even make them poorer.

The Scene

In reviewing the distinctive characteristics of the 13 economies that have been able to grow at more than 7 percent for periods of more than 25 years since 1950, the Commission on Growth and Development (2008) found that sustainable high economic growth requires, among other things, leadership and governance; engagement with the global economy; high rates of investment and savings; mobile resources, especially labor; and inclusiveness to share the benefits of globalization, provide access to the underserved, and deal with issues of gender inclusion. However, observing that successful economies display a number of commonalities and desirable features is of little help in understanding why and how those countries have been able to nurture and sustain these specific features over time. Why are certain countries better governed than others, save and invest more, have more flexible markets, or achieve greater inclusiveness? Are there some admittedly more fundamental common characteristics that could explain why, on average, certain countries create better institutions, promote better policies, and achieve better outcomes?

Although a general theory of economic growth continues to elude the economist profession (Easterly 2001), the idea that differences in societies' institutional arrangements are the fundamental cause of differences in economic performance has gained enormous momentum in recent decades. Since the days of North and Thomas (1973), it has become clear that, although factor accumulation, innovation, and technological progress are the proximate factors that explain the mechanics of economic growth, they are *not* the causes of growth; they *are* growth. To locate the more fundamental determinants of growth, one needs to push the question back one step and ask why factor accumulation and innovation advance at different rates in different countries or groups of countries; why countries differ in terms of level of schooling, quality of infrastructure, health of the population, and other proximate factors of economic growth. The growing consensus is that the answer has to do with differences in institutions (for example, the rule of law, property regime, and participatory process) and differences in geography and other exogenous factors. Analyzing the genesis and development of institutions, some scholars have tried to push the issue back even farther to ask why institutions differ across countries in the first place. Could it be that certain norms, values, and organizational principles in societies are conducive to better institutions? For instance, Acemoglu, Johnson, and Robinson (2004) suggest that political institutions and the distribution of resources are the fundamental determinants of institutions and, therefore, of growth. Chauffour (2009) hypothesizes that the extent to which political institutions and human interactions in society are formed around the concept of *freedom* constitutes one key determinant of growth—perhaps the ultimate cause for economic agents to actually create and accumulate.

The Hypothesis

The starting proposition is that economic development can simply be seen as the product of exogenous and endogenous factors. Exogenous factors are all factors that are *not* under the control of individuals, such as geography, natural resource endowment, ethnolinguistic homogeneity, and various other types of good and bad luck. Endogenous factors correspond to factors that are influenced by individuals—alone or in associations. Those endogenous factors, in turn, can be divided between factors that are mainly the expression of free individual choices leading to market solutions and factors that are the results of more coerced individual decisions leading to political solutions.

Freedom conditions would include all forms of economic freedom, civil rights, and political liberties. These are essentially "negative" rights in nature and are mainly covered by the Universal Declaration of Human Rights and the United Nations International Covenant on Civil and Political Rights. In contrast, coercive conditions would include the regulations, taxations, and other forms of government interventions to provide for public goods and various entitlement rights. Beyond a certain threshold of government intervention, these entitlement rights are essentially "positive" rights in the spirit of the economic, social, and cultural rights as provided by the United Nations International Covenant on Economic, Social, and Cultural Rights.

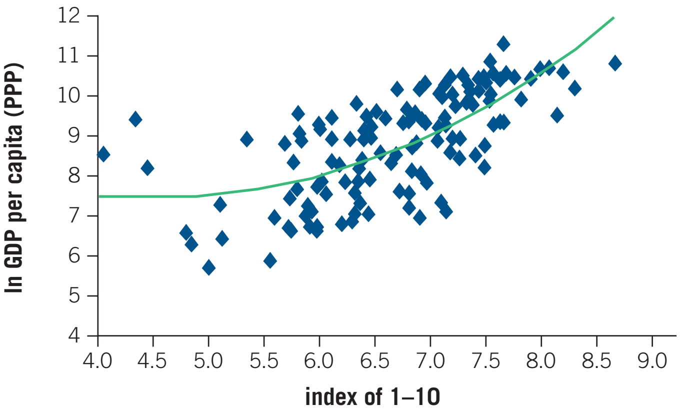
Of course, the problem of when exactly government intervention starts interfering with individual choices and the market is open to reasoned debate. In the final analysis in a democratic context, it is often believed that the scope of the state is a matter for the democratic process to decide. However, although societies may reveal different preferences regarding the trade-off between state intervention and economic freedom, the majority rule may not necessarily lead to the optimal state, either from a normative or from a utilitarian perspective—especially when it violates the freedom of minorities (for example, through discrimination, expropriation, or confiscatory taxation). Friedman (1962) notoriously pointed out that *market* solutions (that is, voluntary cooperation among responsible individuals) permit "unanimity without conformity" (p. 33) (that is, a system of effective proportional representation), whereas *political* solutions (even in proportional representation) typically tend to produce the opposite: "conformity without unanimity" (p. 33). From this position, he concluded that the wider the range of activities covered by the market, the fewer the issues on which explicitly political decisions were needed and, hence, required agreement. In turn, the fewer the issues on which agreement was necessary, the greater the likelihood of reaching agreement while maintaining a free society.

In this understanding of the world, development could be subdued to three fundamental sets of circumstances: (1) a set of exogenous conditions; (2) the degree of individual freedom and market solutions; and (3) the degree of state intervention and political solutions, including the intervention needed to protect individual freedom itself. Certain countries may be able to sustain better institutions and outcomes over time because of a better mix of these circumstances.

Economic Freedom

The main dimensions of economic freedom generally include the freedom to hold and legally acquire property; the freedom to engage in voluntary transactions, inside or outside a nation's borders; the freedom from government control of the terms on which individuals transact; the freedom from government expropriation of property (for example, by confiscatory taxation or unanticipated inflation); and the freedom to move freely within and across international boundaries. There are several theoretical reasons why institutions and policies guaranteeing economic freedom conceivably have the capacity to provide growth-enhancing incentives: they promote a high return on productive efforts through low taxation, an independent legal system, and the protection of private property; they enable talent to be allocated where it generates the highest value; they foster a dynamic, experimentally organized economy in which a large amount of business trial and error and competition among different players can take place because regulations and government enterprises are few; they facilitate predictable and rational decision making by means of a low and stable inflation rate; and they promote the flow of goods, capital, labor, and services to where preference satisfaction and returns are the highest (Berggren 2003). Figure 1 illustrates the relationship between economic freedom (as measured by the Fraser Institute) and per capita GDP in more than 100 countries in 2007.

Figure 1. Economic Freedom vs. Per Capita Income, 2007



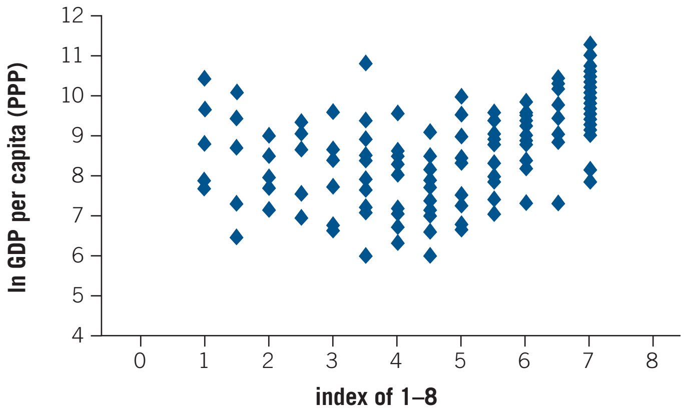
Sources: Fraser Institute and World Bank.
Note: PPP = purchasing power parity.

Economic freedom and free markets give spontaneous satisfaction to people's demands and constitute the main engine for technological progress and economic growth. In turn, sustained and vigorous economic growth creates the conditions for achieving various human development goals, including economic, social, and cultural ones. Friedman (2005) argues that economic growth gives benefits far beyond the material: it brings "greater opportunity, tolerance of diversity, social mobility, commitment to fairness and dedication to democracy" (p. 4). And, conversely, when there is economic stagnation or decline, the citizen's "moral character" tends to decline accordingly, there being less tolerance, less openness, and less generosity to poor and disadvantaged people. Economic freedom is the recognition that being forced not to behave according to one's preferences is utility reducing and costly.

Civil and Political Liberties

Economic freedom is only one dimension of individual freedom. Other dimensions—such as those related to civil rights and political liberties—are equally fundamental. All three dimensions of freedom essentially aim at freeing human beings from various types of state and nonstate violence and "unfreedoms." Sen (1999) takes the view that securing economic rights will not achieve the expected economic benefits in case of civil and political rights violations. When the state does not refrain from physically harming its citizens (through means ranging from arbitrary imprisonment to politically motivated killings), the resulting climate of fear and anxiety is unlikely to be conducive to investment and growth. Rodrik (2000) conjectures that democratic countries would favor higher-quality growth—that is, a more predictable long-term growth rate, greater short-term stability, better resilience to adverse shocks, and a more equitable distribution of wealth. Civil and political liberties would also usually be associated with greater gender equality, higher levels of female education, lower reproduction and infant mortality—all factors contributing to economic growth. Figure 2 shows the relationship between civil and political rights (as measured by Freedom House) and per capita GDP in more than 100 countries in 2007.

Figure 2. Civil and Political Rights vs. Per Capita Income, 2007



Sources: Freedom House and World Bank.
Note: PPP = purchasing power parity.

A number of theoretical arguments have been advanced to make the case that civil and political freedom and economic freedom are mutually reinforcing. Civil and political freedom is expected to facilitate the functioning of the market economy by developing a more predictable and stable institutional framework for engaging in productive transactions, including better protection of property rights. This has a positive influence on economic growth through higher savings and investment rates and through lower rents associated with corruption, government controls, and the lack of respect for the rule of law. Also, political rights and civil liberties are usually conducive to faster economic growth because of the need for political legitimacy of the government undertaking economic reforms with possible short-term costs, the need for an independent judicial system to carry out a successful economic liberalization, and the fact that respect for property rights is most often achieved in societies where civil liberties and political rights are guaranteed.

Entitlement Rights

To ensure the protection of the various forms of economic, civil, and political freedoms discussed above requires an efficient state—that is, a state able to effectively fulfill the core functions of government responsibility (such as the protection of persons, contracts, and properties; the maintenance of the rule of law and justice; and the provision of public goods). However, political circumstances (being democratic or undemocratic) often lead the state to take on a more ambitious range of activities to directly foster growth, promote development, and achieve a number of social objectives (such as reducing inequality or promoting social justice). Typically, those activities would involve political solutions—as opposed to market solutions—that entail an enlargement of the scope of the state and the creation of entitlements (for instance, to social security, health, education, food, housing, work, an adequate standard of living, and so forth). To deliver those entitlements, the state interferes with the market—for instance, to directly produce manufacturing goods (through state-owned enterprises), to supply services (such as education, health, energy, transport, telecommunications, and culture), to control prices (through wages, interest rates, rents, and commodities) or quantities (via credits, quotas, licensing, and other barriers to entry), and to redistribute income (through taxes, subsidies, and transfers).

The relationship between the size of government and economic growth has been extensively studied and tested in the literature, using many different econometric techniques, empirical settings, and samples of countries. But results presented in the literature have been mixed and inconclusive (Bayraktar and Moreno-Dodson 2010). In his seminal paper, Barro (1991) concludes that government expenditure is positively linked to economic growth when the share of government expenditure (and, consequently, the tax rate) is low; but it then turns negative because of increasing inefficiencies as the share of expenditure increases, indicating a nonlinear relationship between government expenditure and growth. Such findings could be explained by the key initial role of the state in providing some fundamental public goods to protect liberty itself—economic freedom and civil and political rights. However, when the scope of the state expands to cover many economic and social areas, its impact on economic growth could turn negative. Figure 3 illustrates the relationship between entitlement rights (as measured by the Fraser Institute) and per capita GDP in more than 100 countries in 2007.

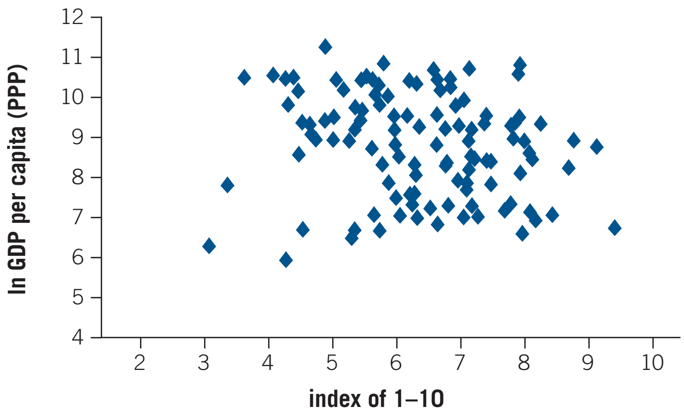
Empirical Evidence

The multifaceted concepts of economic freedom, civil and political rights, and entitlement rights are difficult to measure; and the data used in any empirical analysis are necessarily imperfect proxies for the underlying concepts. Furthermore, the inevitable gaps between the conceptual frameworks and the measured concepts complicate the empirical verification of the hypothesis. This caveat notwithstanding, new empirical analysis in a sample of more than 100 countries over the last 30 years suggests that, for a given set of exogenous circumstances, the respect for and promotion of economic freedom and civil and political rights (measured by the Fraser Institute's Economic Freedom of the World index and the indexes of civil rights and political liberties published by Freedom House) are, on average, strongly associated with a country's per capita income growth over the long run (Chauffour 2011):

- A one-unit change in the initial level of economic freedom on a scale of 1 to 10 (for example, the difference between Argentina and Turkey in 1975) is associated with an increase of almost 1 percentage point in the average economic growth rate during the period (p. 19).
- A one-unit increase in the economic freedom rating during the earlier decade results in an increase of more than a 1.3 percentage points in the average growth rate over the whole period, whereas a unit increase in the economic freedom rating during the later decade results in an increase of 0.9 percentage point in the average economic growth rate over the entire period (p. 20).
- A one-unit change in initial civil and political rights conditions on a scale of 1 to 8 (for example, the difference between Mongolia and Chile in 1975) increases average economic growth by more than 0.3 percentage point during the period (p. 20).
- A one-unit increase in the civil and political rights conditions during the period is only weakly associated with an increase in per capita GDP (p. 20).

In contrast, the analysis finds that the extent to which the state expands its scope to provide entitlement rights (mea-

Figure 3. Entitlement Rights vs. Per Capita Income, 2007



Sources: Fraser Institute and World Bank.
Note: PPP = purchasing power parity.

sured by the Fraser Institute's Economic Freedom of the World index) does not add significant explanatory power in estimating countries' growth performance over the long run. In the estimates where it does add such power, the findings would suggest a negative effect of entitlement rights on economic growth. In line with earlier literature, this may indicate that the role of the state in economic growth is ambiguous. When the state limits itself to the core functions of government responsibility, including the protection of various forms of freedom and the provision of key public goods, it is likely to have a strong positive influence on growth. However, when the state grows beyond the size needed to fulfill these core functions, it may dampen economic growth (everything else being equal). This nonlinear effect between government intervention and economic growth is not easy to test because there is no guarantee (and, for that matter, little evidence) that governments necessarily prioritize the core functions of government responsibility over other forms of government intervention.

As far as the exogenous circumstances are concerned, consistent with the economic theory and previous studies, poorer countries tend to grow faster; countries located in the tropical climate and far away from the world's biggest markets tend to growth slower than otherwise-similar countries in different locations; countries with higher proportions of coastal population grow faster; and, controlling for all other variables, countries that possess subsoil assets tend to grow faster. In other words, when natural resource abundance does not lead to greater corruption and various forms of rights violations and inefficiencies, the economy that, in addition, is abundant in natural resources will tend to grow faster.

Conclusion

New empirical evidence suggests that fundamental freedoms are paramount to explain long-term economic growth. For a given set of exogenous conditions, countries that favor free choice—economic freedom and civil and political liberties—over entitlement rights are likely to achieve higher sustainable economic growth and to achieve many of the distinctive proximate characteristics of success identified by the Commission on Growth and Development (2008). In contrast, pursuing entitlement rights through greater state coercion is likely to be deceptive or self-defeating in the long run.

These findings provide potentially important policy lessons for all countries. For developed countries, they suggest that prioritizing economic freedom over social entitlements could be an effective way to reform the welfare state and make it more sustainable and equitable in the long run. For middle-income countries (such as countries in the midst of the Arab Spring and countries in Asia and Latin America), they indicate that the quest for civil and political rights and for economic freedom could create the conditions for new social contracts. For low-income countries, they provide an opportunity to reflect on the achievements under the Millennium Development Goals and the potential role that economic freedom and other fundamental freedoms could play in a post-2015 Millennium Development Goals development agenda.

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