

Chapter 3

What Matters for Development—Freedom or Entitlement?

by Jean-Pierre Chauffour

How can we keep the government we create from becoming a Frankenstein that will destroy the very freedom we establish it to protect? Freedom is a rare and delicate plant

Milton Friedman, *Capitalism and Freedom*, p.2

Introduction

In reviewing the distinctive characteristics of the 13 economies that have been able to grow at more than 7% 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 economists (Easterly, 2001),¹ 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, while 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 do countries differ in the level of schooling available, 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 (e.g., the rule of law, the

Foundation on May 25–27, 2011. The views expressed in this chapter are solely my own and should not be attributed to the World Bank, its Executive Directors, or the countries they represent. I can be contacted at: jchauffour@worldbank.org.

- 1 Broadly speaking, three theories of economic growth are usually discussed in the literature: the neoclassical growth theory, which emphasizes the accumulation of factors (labor and capital) and technological progress (exogenous or endogenous) as the primary determinants of growth (e.g., Solow, 1956; Mawkin, Romer and Weil, 1992); the geographic growth theory, which emphasizes climatic conditions, access to major markets, and other locational factors as key to explaining long-term economic development (e.g., Diamond, 1997; Sachs, 2001); and the institutional growth theory, which stresses the importance of a society's institutional framework, in particular the existence of a market-friendly environment for entrepreneurial activities, in the long-term performance of economies (e.g., North, 1990; Acemoglu and al., 2004).

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property regime, and the participatory process) and differences in geography and other exogenous factors.²

Analyzing the genesis and development of institutions, some scholars have tried to push the issue back even further 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.

Looking at the economic performance—good and bad—of more than 100 countries over the last 30 years, this chapter proposes to (1) re-examine the long-term relationship between freedom and economic growth; and (2) disentangle the respective role of economic freedom, civil, and political liberties, and the pursuit of economic, social and cultural rights on economic growth. In line with the analytical framework of the rights-based approach to development, the chapter conjectures that development is rooted in the protection of some fundamental rights. It further conjectures, however, that all so-called “rights” are not necessarily equal and that the individual rights at the root of sound institutions and sustainable economic growth may not necessarily coincide with the rights embedded in the instruments of international human-rights law. In particular, the rights that foster the pursuit of freedom (i.e., economic freedom, and civil and political liberties) and entitlement “rights” (i.e., right to food, housing, education, health, and so on) may lead to different institutions and development outcomes over the long run.

Concepts

The starting proposition is that, at the simplest level, economic development can be seen as the product of exogenous and endogenous factors. Exogenous factors are those factors that are *not* under the control of individuals,

such as geography, natural-resource endowment, ethno-linguistic homogeneity, and various other types of good and bad luck. Endogenous factors would correspond to factors that are influenced by individuals, alone or in associations. Those endogenous factors can in turn 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 covered by the Universal Declaration of Human Rights and the UN 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 UN International Covenant on Economic, Social, and Cultural Rights (Box 3.1).

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, majority rule may not necessarily lead to the optimal state, either from a normative or utilitarian perspective—especially when it violates the freedom of minorities (e.g., discrimination, expropriation, confiscatory taxation). Friedman notoriously pointed out that *market* solutions (that is, voluntary cooperation among responsible individuals) permit “unanimity without conformity” (that is, a system of effective proportional representation), whereas *political* solutions (even those with proportional representation) typically tend to produce the opposite: “conformity without unanimity” (1962: 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. Depending on the balance between market solutions and political solutions, individual opportunities to learn, own, work, save, invest, trade, protect, and so forth may vary greatly across countries and over time.

2 Acemoglu, Johnson, and Robinson, 2005; Alesina, Easterly, Devleeschauwer, Kurlat, and Wacziarg, 2003; Gallup, Sachs, and Mellinger, 1998; Frankel and Romer, 1999; Glaeser, La Porta, Lópezde-Silanes, and Shleifer, 2004; Knack and Keefer, 1997; Rodrik, Subramanian, and Trebbi, 2004.

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

Development as economic freedom

Economic freedom is in itself part and parcel of the basic liberties that people have reason to value. As Sen puts it, “the freedom to exchange words, or goods, or gifts does not need defensive justification in terms of their favorable but distant effects; they are part of the way human beings in society live and interact with each other (unless stopped by regulation or fiat)” (1999: 61). Economic freedom in all its dimensions, therefore, has an intrinsic value irrespective of its impact on economic growth and development and this value is not limited to egotism and selfishness. Indeed,

freedom has been defined as “a state in which each can use his knowledge for his purposes” (Hayek, 1973: 55–56).

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 a country 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;

Box 3.1: Negative and positive rights

The distinction between positive and negative rights is controversial and at the core of differing interpretations about human rights. Negative rights conceive of human rights in terms of liberties and “freedoms from.” They derive primarily from seventeenth- and eighteenth-century reformist theories (i.e., those associated with the English, American, and French revolutions). Imbued with the political philosophy of liberal individualism and the related economic and social doctrine of *laissez-faire*, they are fundamentally civil and political in nature and opposed to government intervention in the quest for human dignity. In contrast, positive rights see human rights more in terms of claims, entitlements, and “rights to.” They originated primarily in the nineteenth-century socialist tradition and were taken up by the revolutionary struggles and welfare movements of the early twentieth century. As a counterpoint to “negative” civil and political rights, they tend to favor state intervention for the purposes of providing economic, social, and cultural rights and ensuring the equitable distribution of the values or capabilities involved.

Acknowledging the intellectual challenge posed by the promotion of both negative and positive rights in international human-rights law, a number of scholars have tried to reconcile views by emphasizing the continuum between both sets of rights. First, positive rights have been defended on the grounds that the protection of negative rights also entails positive actions by the state that could be as costly as the realization of a number of positive rights (Alston, 2004). Second, positive rights have been promoted on the basis that all human rights involve a mix of negative and positive duties and entitlements. However, this line of argument tends to brush aside the fact that the fundamental distinction between positive and negative rights is about the essence of those rights and not, as has often been claimed, about the economic costs of implementing them. Hayek (1960) has elaborated on the good reasons for guaranteeing basic human rights, even if they are costly. Indeed, promoting and protecting negative rights that underpin economic freedom and civil and political liberties requires a government that is streamlined, yet strong and effective.

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 3.1 illustrates the relationship between economic freedom (as measured by the Fraser Institute; Gwartney and Lawson, 2009) and per-capita GDP in more than 100 countries in 2007. Countries that enjoy high levels of economic freedom are those that are associated with higher levels of economic development.

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 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" (2005: 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.

Development as 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 non-state 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 lower infant mortality—all factors contributing to economic growth. Figure 3.2 shows the relationship between civil and political rights (as measured

Figure 3.1: Economic freedom vs. per-capita income, 2007

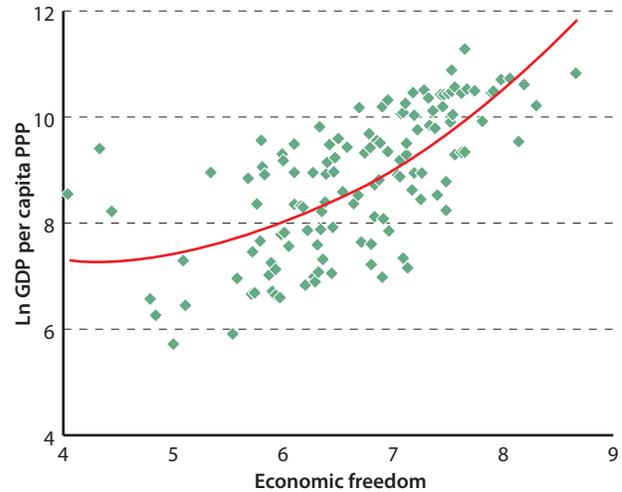
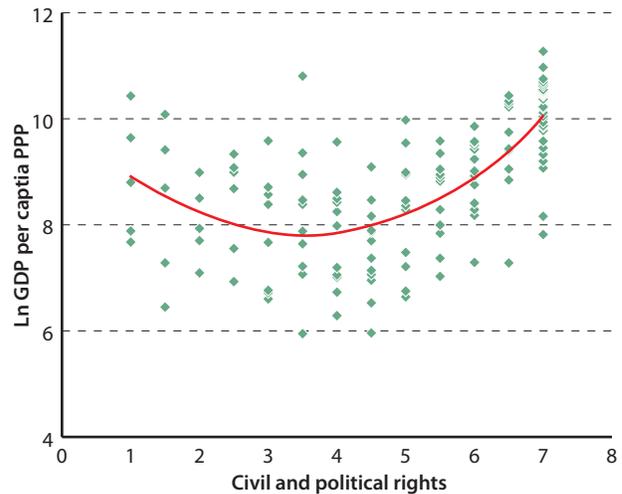


Figure 3.2: Civil and political rights vs. per-capita income, 2007



by Freedom House) and per-capita GDP in more than 100 countries in 2007. At a first glance, the relationship seems to be non-linear, where countries with low and high levels of civil and political rights register slightly higher levels of GDP per capita as compared to countries with intermediate levels of civil and political rights.

A number of theoretical arguments have been advanced to make the case that civil and political freedom and economic freedom are mutually reinforcing. (For an empirical examination of this issue, see Lawson and Clark, 2010.) 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 on the part 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.

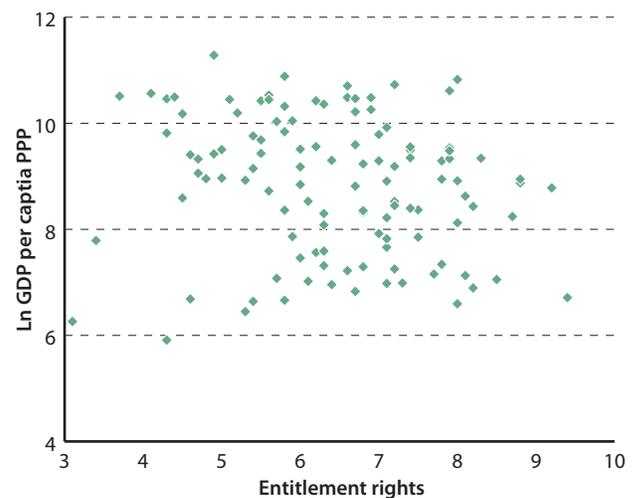
Development as entitlement rights

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 effectively to 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 foster growth directly, 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 produce manufacturing goods directly (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 a recent paper trying to explain why both the Scandinavian and the Anglo-Saxon welfare states seem able to deliver high growth rates for very different levels of government size, Bergh and Henrekson (2011) suggest that, first, countries with higher social trust levels are able to develop larger government sectors without harming the economy, and,

second, countries with large governments may compensate for high taxes and spending by implementing market-friendly policies in other areas. 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 3.3 illustrates the relationship between entitlement rights (as measured by the Fraser Institute, see definition below) and per-capita GDP in more than 100 countries in 2007. There is no apparent clear relationship between the level of entitlement rights and the level of development.

Figure 3.3: Entitlement rights vs. per-capita income, 2007



Data and model

Sources of data

The concepts of economic freedom, civil and political rights, and entitlements rights are notoriously difficult to quantify and attempts to grasp such complex subjects in one summary index can only be deceptive. Each concept is wide in scope (both breadth and depth) and impossible to summarize in one all-encompassing indicator. The best that can be done is to approach each concept through a combination of measurable indicators and proxies. The data used in this chapter includes the index of *Economic*

Freedom of the World of the Fraser Institute and the indices of *Civil Rights and Political Liberties* published by the Freedom House. These are among the few available databases that cover those concepts for a large sample of countries and a relatively long period of time in a comprehensive and consistent way.

Index of economic freedom

The index of economic freedom (EFW) used in this chapter is the simple average of four of the five areas of the index published in the Fraser Institute's *Economic Freedom of the World* (EFW), namely (2) Legal Structure and Security of Property Rights, (3) Access to Sound Money, (4) Freedom to Trade Internationally, and (5) Regulation of Credit, Labor, and Business.³ In turn, each area consists of a number of components and sub-components. Area 2 measures the degree of judicial independence, impartial courts, protection of property rights, military interference in rule of law and the political process, integrity of the legal system, legal enforcement of contracts, and regulatory restrictions on the sale of real property. Area 3 measures money growth, standard deviation of inflation, rate of inflation, and freedom to own foreign currency bank accounts. Area 4 measures taxes on international trade, regulatory trade barriers, the size of the trade sector relative to expected, the black-market exchange rate, and the extent of international capital market controls. Area 5 measures credit market regulations, labor market regulations, and business regulations. The EFW index is constructed if the data is available on at least three out of the four areas of economic freedom; otherwise we marked the data as missing.

Index of entitlement rights

The index of entitlement rights (ER) is computed from Area 1: Size of Government of the index of *Economic Freedom of the World*. It is a rough proxy to measure the inclination of government to expand the scope of their activities in providing goods, services and entitlements. Area 1 includes general government consumption spending as a percentage of total consumption, transfers and subsidies as a percentage of GDP, government enterprises and investment, and top marginal tax rate. Because this measure is both broad and limited, it necessarily hides a lot of heterogeneity, especially regarding the quality of public expenditures and other forms of government intervention.

3 The publication and data tables are available from <<http://www.freetheworld.com/>>. See Exhibit 1.1 in this volume for full list of areas, components, and sub-components of the EFW Index.

In particular, among small governments, the index cannot distinguish between failed states and more effective states. Among larger governments, the index cannot differentiate efficient welfare states from ineffective and wasteful rent-seeking states. Yet, the index aims at capturing the overall characteristic that governments with large public spending, transfers, and subsidies, numerous government enterprises, and high marginal tax rates are generally prone to provide various forms of entitlement.⁴ The value of the index has been reversed so that the higher levels represent larger governments and, by extension, more extensive provisions of entitlement rights.

Index of civil and political rights

The index of civil and political rights (CPR) is computed as the simple average of Freedom House's Civil Rights (CR) and Political Liberties (PL) indices (Freedom House, 2011). Civil rights indicates whether citizens are able to participate freely in the political process: do they have the right to vote for distinct alternatives in legitimate elections, compete for public office, join political parties and organizations, as well as elect representatives that have a distinct impact on public policies and are accountable to the public? Political liberties allow for freedom of expression and belief, association and organization rights, rule of law and personal autonomy. The scale of the CPR index has been reversed from that of the Freedom House indices, so that the higher the rating, the higher the level of freedom. Because the indexes of civil rights and political liberties are highly correlated,⁵ we create a joint index of civil and political rights (CPR).

Control variables

A number of control variables are used to depict exogenous factors: geography (Tropics), whether a country is landlocked (Pop100km), or remote (Remoteness). To control for geography, we use the data from Gallup, Sachs, and Mellinger (1998) on the extent of land located in the geographical tropics. To control for a country's being landlocked, we also use the data from Gallup, Sachs and Mellinger (1998) on the proportion of the country's

4 For example, entitlement to healthcare, education, pension; to free or highly subsidized food, water, energy, and other goods and services; to public housing, controlled rents, or publicly guaranteed mortgages; to public employment, minimum wages; to protection from foreign and domestic competition through bans, quotas, and other limits to entry.

5 The Spearman rank correlation between the two indices over the period from 1970 to 2007 amounts to 0.93.

populations living within 100 km of the coastline or ocean-navigable river. To control for remoteness, we include a measure of the average distance to the world markets in line with the work of Redding and Venables (2004). We calculate as distance-weighted average GDP of all other countries in our sample. The measure of distance originates from the CEPII data base and represents the geographical distance between the capital cities.

Dummy variable

Finally, given the possible noise introduced by initial conditions in terms of natural resource endowments, we include a dummy variable for countries with subsoil assets (World Bank, 2006). We refer to this dummy variable as Resources. It should be noted, however, that the effects of natural endowments on long-term economic growth is unclear. Sachs and Warner (1997) find support for the hypothesis that countries rich in natural resources tend to grow more slowly. The authors include the ratio of natural resource (fuels and non-fuel primary products) exports to GDP in the base year and find it to be negatively correlated with economic growth. Similarly, Barro (1997), who includes a dummy variable for oil-rich countries in the growth regression finds it to be negative and statistically significant. However, several more recent studies found that the presence of natural resources does not necessarily present an impediment to higher growth; it depends on other policies pursued by the countries (e.g., Lederman and Maloney, 2007). The data on GDP per capita and the amount of net overseas development assistance per capita (ODI) originate from the World Bank World Development Indicators data base.⁶

Model

The methodology applied in this study follows closely that applied by Dawson (1998) who starts from the Mankiw, Romer, and Weil's (1992) human-capital-augmented version of the Solow's (1956) model:

$$Y_t = K_t^\alpha H_t^\beta (A_t L_t)^{1-\alpha-\beta}$$

$$\alpha, \beta > 0, \alpha + \beta < 1$$

where Y is aggregate output, K is physical capital, H is human capital, L is labor, and A is the level of (labor-augmenting) technology.

The model then relaxes the hypothesis of exogenous rates of growth of physical capital, human capital, and technology and assumes that these variables grow as

a function of the more fundamental determinants of accumulation that constitute economic freedom (EF), civil and political rights (CPR), entitlement rights (ER), and exogenous conditions. Given that the quantity and quality of physical capital and human capital are notoriously difficult to measure and almost impossible to collect across countries on a timely and consistency basis, we bypass the estimation of the direct effects of EF, CPR, and ER on the accumulation of physical and human capital and estimate instead the following reduced form:

$$\Delta Y_i/Y = \alpha_0 + \alpha_1 Y_{i0} + \alpha_2 EF_{i0} + \alpha_3 \Delta EF_i/EF + \alpha_4 CPR_{i0} + \alpha_5 \Delta CPR_i/CPR + \alpha_6 ER_{i0} + \alpha_7 \Delta ER_i/ER + \alpha_8 X_i + \epsilon_i$$

where $\Delta Y_i/Y$ is the average growth of per-capita GDP of country i ; Y_0 is the initial level of GDP; EF_{i0} , CPR_{i0} , and ER_{i0} are the initial levels of the economic freedom index, civil and political rights index, and entitlement rights index, respectively. $\Delta EF_i/EF$, $\Delta CPR_i/CPR$, and $\Delta ER_i/ER$ are percentage point changes in the respective indexes over the period under investigation, while X_i is a vector of control variables determined by geography and natural resources (i.e., Tropics, Remoteness, Pop100K, and Resources). As indicated earlier, Tropics represents the extent of land located in the geographical tropics, Remoteness measures the average distance to world markets, Pop100K indicates the proportion of population living within 100 km of the coastline or ocean-navigable river, and Resources is a dummy variable for countries with subsoil assets.

Results

The results presented in this section are a best endeavor to test the theoretical discussion with available data. As already indicated, the multifaceted concepts of economic freedom, civil, and political rights, or entitlement rights are difficult to measure and the data used in the empirical analysis are necessarily imperfect proxies of the underlying concepts. And, the gaps between the conceptual framework and the measured concepts only complicate further the empirical verification of the ideas motivating the chapter. This caveat notwithstanding, the empirical analysis suggests that, for a given set of exogenous circumstances, respect for and promotion of economic freedom and civil and political rights are on average strongly associated with a country's per-capita income growth over the long run. In contrast, in most estimates, the extent to which the state expands its scope to provide entitlement rights does not add significant explanatory power in estimating countries' growth performance over the long run.

6 Database available from <<http://data.worldbank.org/data-catalog/world-development-indicators>>.

In the estimates where it does, the results would suggest that entitlement rights have a negative effect on economic growth. These findings are consistent in both the cross-section and panel estimates.

Cross-section estimates

Table 3.1 presents cross-section estimates of the model specification for about 100 countries (depending on data availability) over 30 years. The dependent variable is the average growth of the GDP per capita in constant US\$ from 1975 to 2005. The various specifications allow for various combinations of variables to check the robustness of the estimated relationship. The first regression is similar to the specification employed by Gwartney, Holcome and Lawson (2006). Economic growth is mainly explained by the initial level of economic freedom and its growth over decades. This specification isolates the persistence of the impact of previous changes in economic freedom on economic growth. Using the same approach, we introduce the initial level and changes over time of the civil and political rights, and entitlement rights. In addition to the initial level of the GDP per capita we add the control variables as discussed in the previous section: Pop100km, Tropics, Resources, and Remoteness.

The results indicate that the level of economic freedom contributes to economic growth. We find that the level of economic freedom is consistently statistically significant across all specifications and has a positive impact on economic growth. For example, in the most comprehensive specification in the column 7 of table 3.1 our results indicate that a one-unit change in the initial level of economic freedom (on a scale of 1 to 10) is associated with an increase of almost one percentage point in the average economic growth rate during the period. As an example, Argentina with an economic freedom rating of 2.84 in 1975 could have expected an average growth rate one-percentage point higher than its actual growth rate over the period had its initial level of freedom been that of Turkey (3.84). A similar comparison can be made between Turkey and Israel (4.8) or Israel and Cyprus (5.9) or Cyprus and Singapore (7.0) and finally Singapore and Luxembourg (8.15).

The results indicate that the change in economic freedom over time also contributes to economic growth. Improvements in economic freedom have a persistent impact on economic growth as growth in economic freedom in previous decades affects economic growth to a larger extent than the more recent changes in economic freedom. Specifically, a unit increase in the economic freedom rating during the earlier decade results in more than

a 1.3 percentage-point increase in the average growth rate over the whole period, while a unit increase in the economic freedom rating during the later decade results in a 0.9 percentage-point increase in the average economic growth rate over the entire period.

We also find the evidence of a positive impact of civil and political rights on economic growth. The initial level of civil and political rights is consistently statistically significant and positive across all regressions. A one-unit change in initial civil and political rights conditions on a scale of 1 to 8 (i.e., the difference between, say, Mongolia and Chile in 1975) increases average economic growth by more than 0.3 percentage point during the period (column 7 of table 3.1). A similar conclusion is reached if one compares the initial conditions of Chile (with a CPR of 2) and Egypt (CPR of 3), and then Egypt and Portugal (CPR of 4), Portugal and Monaco (CPR of 5), Monaco and Greece (CPR of 6), and finally Greece and the United States (CPR of 7). However, the results indicate that changes in civil and political rights conditions over time are not always associated with increased per-capita GDP. The coefficients of changes in civil and political rights are in some specifications statistically significant and positive, but the relationship is not robust to different specifications.

Finally, we do not find any robust relationship between entitlement rights and economic growth. The initial level of the entitlement right is negative and statistically significant in regression where only this variable has been included (column 3) and not statistically significant in other specifications. The change in entitlement rights seems to influence the average economic growth positively, but this relationship is not robust to the inclusion of economic freedom. In line with earlier literature, this may indicate that the role of the state on economic growth is ambiguous. When the state limits itself to the core functions of governmental 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.

This nonlinear effect between government intervention and economic growth is not easy to test as 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. In other words, a country with a low ratio of government spending to GDP may not necessarily maintain the rule of law and justice or provide the core public

Table 3.1: Economic growth and economic freedom, civil and political rights, and economic and entitlement rights—cross-section estimates

	Coefficient						
Column	1	2	3	4	5	6	7
EF	1.099***			0.946***	1.071***		0.969***
dEF 1985–1994	1.335***			1.250***	1.045***		1.375***
dEF 1995–2004	0.994***			0.827***	1.047***		0.928***
CPR		0.562***		0.428***		0.446***	0.332**
dCPR 1985–1994	0.426**		0.328*		0.335	0.230	
dCPR 1995–2004	0.267*		0.210		0.264*	0.127	
ER			–0.255*		–0.111	–0.192	–0.524
dER 1985–1994		0.013		0.108	0.029	0.121	
dER 1995–2004		0.016		0.308**	0.026	0.283*	
initial GDP per capita	–0.740***	–0.585***	–0.290**	–0.868***	–0.766***	–0.496***	–0.879***
Tropics	–1.694***	–2.179***	–2.413***	–1.660***	–1.803***	–2.343***	–1.748***
Resources	0.526	0.625	–0.099	1.041**	1.069**	0.616	1.360**
Pop100km	1.286***	1.660***	2.082***	0.813*	1.279***	1.599***	0.922*
Remoteness	–0.148**	–0.190**	–0.201**	–0.125*	–0.127*	–0.170**	–0.110
Constant	–5.202***	–1.281*	1.934**	–5.733***	–7.370***	0.181	–5.121***
No. of countries	98	109	105	97	98	103	97
Adjusted R-sq:	0.562	0.429	0.405	0.588	0.599	0.429	0.608

*** significant at 1%, ** significant at 5%, * significant at 10%.

Dependent variable: average annual growth of GDP per capita in constant US\$ from 1975 to 2005.

goods that are necessary to protect fundamental freedoms and hence development. Conversely, a country with a large welfare state, while distorting incentives and dampening economic growth, may deliver those core functions of government responsibility perfectly. The methodology and data used in this chapter do not allow investigating this issue further. This would require additional research.

Consistent with economic theory and all previous studies, the results indicate that the initial level of GDP per capita is statistically significant and has the expected negative sign in all specifications. Poorer countries tend to grow faster. Also, all control variables except for Resources are statistically significant in all specifications and have the expected signs. We find that countries located in the tropical climate and far away from the world's biggest markets tend to grow more slowly than otherwise similar countries in different locations. We also find that higher proportion of coastal population is associated with faster

growth. The impact of resources on growth turns out to be statistically significant and positive in three out of 7 regressions. This would suggest that, controlling for all other variables, countries that possess subsoil assets tend to grow faster. This is not necessarily inconsistent with the findings of some previous studies that found a negative impact of resource abundance on economic growth. It has been argued that abundant natural resources might lead to greater corruption and inefficient bureaucracies or that the governments in resource-rich economies are more likely to follow some form of state-led development policies or tend to waste the rents through profligate or inappropriate consumption. However, our various indicators of freedom might be controlling for these factors already, hence our results indicate that given two economies with the same level of economic freedom and other attributes, the economy that is in addition abundant in natural resources will tend to grow faster.

Table 3.2: Economic growth and economic freedom, civil and political rights, and economic and entitlement rights—panel estimates

	Coefficient							
Column	1	2	3	4	5	6	7	8
initial EF	1.415***			1.152***		1.358***	1.116***	2.671***
dEF(−1)	1.032**			1.039**		1.069**	1.072**	−0.193
initial CPR		1.087***		0.737***	0.979***		0.691***	0.941**
dCPR(−1)		0.519*		0.700**	0.548*		0.699**	0.548*
initial ER			−0.711***		−0.546***	−0.428**	−0.353*	−1.469***
dER(−1)			0.008		−0.071	0.312	0.188	0.213
initial GDP per capita	−1.072***	−1.436***	−0.659***	−1.181***	−1.014***	−1.048***	−1.149***	−8.474***
Tropics	−2.752***	−3.647***	−3.407***	−2.418***	−3.325***	−3.109***	−2.733***	
Resources	1.471*	3.925***	0.196	2.623***	2.195***	1.613**	2.659***	
Remoteness	−0.241***	−0.445***	−0.336***	−0.243***	−0.328***	−0.245***	−0.246***	
Constant	−4.021**	−0.863	6.591***	−6.283***	1.585	−1.922	−4.406**	
No. of obs.	511	624	573	508	564	511	508	508
No. of countries	121	136	121	121	121	121	121	121
R-sq within	0.087	0.146	0.162	0.118	0.170	0.102	0.131	0.237
R-sq between	0.435	0.308	0.280	0.425	0.340	0.426	0.418	0.075
R-sq overall	0.138	0.146	0.102	0.173	0.159	0.147	0.178	0.004

*** significant at 1%, ** significant at 5%, * significant at 10%.

Dependent variable: average annual growth of GDP per capita in constant USD over 5 year intervals from 1975 to 2005.

Panel estimates

Table 3.2 presents estimates of the relationship between economic freedom and economic growth in a panel of data from 1975 to 2005. The average economic growth is measured over five-year intervals (as the index of *Economic Freedom of the World* is only available every five years from 1975 to 2000). Data on economic freedom is available for 121 countries. As in the cross-section estimates, the dependent variable is explained by the initial levels of the various exogenous variables (EF, CPR, and ER), the changes of those variables in the previous periods (to avoid the problem of endogeneity), and a similar set of control variables.⁷

The panel-data estimates are consistent with the cross-section estimates. We find a robust positive relationship between the initial level of economic freedom and its growth in the previous period. In addition, we find a similar relationship between economic growth and civil and political rights. Both the initial level and changes in the civil and political rights in the previous period contribute positively to the economic growth. This relationship is robust to the inclusion of the indicator of economic freedom. In contrast to the cross-section estimates, we find this time a robust negative relationship between the initial level of entitlement rights and economic growth in all specifications, while we still do not find any statistically significant impact of the change in entitlement rights on economic growth.

All the control variables are statistically significant in most specifications and have the same signs as in the

⁷ We drop the Pop100km variable as it was consistently not statistically significant in the panel regression estimates.

cross section estimates presented in table 3.1. Column 8 of table 3.2 presents the results based on the fixed-effects estimation. The only difference in this specification is that the growth of economic freedom in the previous period does not seem to affect economic growth in the current

period. The overall fit of the fixed-effects regression is poor and it does not seem to be the appropriate way to model the economic growth since the heterogeneity of the data set is driven by cross-country variation and not by time-series variation.

Conclusions

Freedom and entitlement are largely different paradigms for thinking about the fundamentals of economic 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. The empirical findings in this chapter suggest 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 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 (MDG) and the potential role that economic freedom and other fundamental freedoms could play in a post-2015 MDG development agenda.

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